

Twenty Good Summers

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Twenty Good Summers

Work less, live more and make the
most of your money

Martin Hawes

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*This book is dedicated to the memory of Paul Scaife, who died
on Mt Tasman on New Year's Eve 2003.*

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Section | 1

Planning

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Chapter 1 | Twenty good summers

A couple of years ago, I turned 50. Any birthday which has a zero on the end is always a bit of a wake-up call, but for some reason my 50th in particular was accompanied by feelings that time was sliding by. I have always been heavily involved in the outdoors—mountaineering, climbing, hiking and skiing—and I was starting to feel that there were more things to do than I was ever going to have time to do them in. I kept looking at mountains to climb and trips to go on and thinking, ‘How am I ever going to have time to do all this stuff before I get properly old?!’ On my 50th birthday, I spent the day climbing frozen waterfalls. From the top, I could see the vastness that is the Southern Alps of New Zealand and said (for the hundredth time) to my climbing mate, ‘So little time—so much to do!’

This got me thinking: maybe I only have twenty good summers left; twenty good summers to enjoy the mountains and do the other things that I love. In twenty summers I would be 70 (my allotted three score and ten). Hopefully at that age I won’t be dead, and surely I will still be enjoying life (I know lots of people in their 70s, 80s and even in their 90s who are still very active and enjoy life). But chances are that

TWENTY GOOD SUMMERS

by the time I am 70, I won't be doing a lot of the things that I love at the moment—I probably won't be out climbing, doing seminars, running and biking, and so forth. Perhaps I have only twenty good summers to do these kinds of things. Perhaps I won't get even that number, and I am surely not going to get a whole lot more.

Well, last year that twenty good summers came down to nineteen good summers; and this year it reduced to eighteen good summers; and by the time you're reading this book it will be down to seventeen . . . Time no longer stretches forever in front of me, with endless potential. These are small, finite numbers—never-never land is starting to look like it doesn't exist! It really is time to act, to live the life that I want. Assuming that this is the only life we have on this earth (and the evidence to the contrary is not particularly great), now is the time to live it to the full—to spend the remaining summers wisely, making each one count. Maybe I will get more than twenty good summers, but I am not prepared to bet on it! Now is the time to be as free as possible to do the things that I have always wanted to do.

I have told this story at seminars many times now. It always strikes a chord, especially amongst people of a similar age to mine (that is, those who are Baby Boomers). Such people recognise that in spite of what they thought in the past, they are not going to be forever young, and that if there was ever a time to take dramatic steps to live the life that they want, that time is now.

I am a quintessential Baby Boomer. By and large, we Baby Boomers have had a very comfortable, easy existence. We are used to having it every which way: we've had the lifestyle we wanted and we've also had the comfort. We don't want to

work now (or at least not so hard!), but we don't want to go without. As a generation we've had it very good, with no world wars, no depressions, no epidemics, nothing to spoil our easy existence. And we want to keep it good!

These are the things that have characterised the Baby Boomers: we were the 'now' generation. Some of us are still wondering what we are going to do when we grow up. We invented sex. We are starting to discover middle age and tell each other that it does not really start at 40 but at 50 (and we will push that out to 60 when we need to!). No doubt some time soon we will invent death and dying! At least it will seem like it. We established the 'permissive society'. Now we are justifying giving ourselves permission to work less and live more.

Importantly, there are lots of us. As a generation we have always been able to dominate simply because we are large in numbers. As we come to our numerical peak and take political control (and control of our nations' chequebooks!) we will continue our dominance. That there are so many of us makes a big difference to what happens in society and in our economies and business markets. That there are so many of us is important to business, as we create trends that business can sell to. It is also important in that while there are a lot of us (before we start to die off, which is likely to happen very soon) governments will have to support us as we age.

This sizeable generation of people who would never grow old *is* starting to want to change what they do. We have always said that we would never retire—retirement is a swear word to many a Baby Boomer, often having for us the meaning of giving up and withdrawing. So, ever inventive, we have a new word for it: 'lifestyle'. And that is exactly what we

are starting to do now. More and more, we want to surrender our jobs and our houses in the suburbs to pursue lifestyle. Look at the evidence—how we are flocking to the coast or to small farms on the edges of cities. People are downsizing their houses and their jobs to live near a beach or in the country, to work less and play more. The result: soaring prices for coastal land and floods of people buying holiday homes or apartments in the mountains or on the beach.

If truth be told, we Baby Boomers are probably starting to get tired. Some of us have had high-pressure jobs requiring us to work hard for years, and now, finally, the generation that believed it would never age and never want to retire is starting to feel the need to slow down. We do not want to admit to anyone the reality that we are starting to age and really *want* to ‘slow down’ (let alone mention the concept anathema to most of us—‘retirement’). So we seek ‘lifestyle’—a sort of euphemism for retirement without having to use the dreaded word. And, of course, there are so many of us that this is making (and will continue to make for twenty years or so yet) a huge difference to property and other markets.

What does this lifestyle look like? Well, it is working less, having more time, enjoying living in a nice house in a nice place surrounded by good friends and family. It is not about buying a rocking chair, sitting in it and waiting thirty years to die. It is about being active in our hobbies, active in our gardens, active in our communities, active on the beach or in the country, and active in our travel to other countries. It may also mean being active in paid work—albeit not as active as before.

These are the things my clients have told me when they dream their dreams. For the last few years, I have been

actively involved in WealthCoaching—helping people generate and arrange the money they need for the life they want. As part of each session with a new client, I ask about their ideas of a dream life. The things listed above are the things that nearly always come out: more time, more relaxation, travel, contribution to the community, time with the family and stepping back to enjoy the good things in life some more. Above all, the consistent theme is that people want to get out of the daily grind—to have more time, and the money and energy to enjoy it.

However, in easing back so that we can live the lives we want, we need to sort our money out. Our parents might have called this retirement while we call it seeking lifestyle, but the problem is just the same—how do you fund the life you want when you are no longer part of the daily grind? How do we use the capital we *have* to obtain the passive income we *need* to be free? That is what this book is about.

This is a book for anyone who expects to work less and live more on their savings. Whether you are already at that point or aspire to be there in ten years' time, you need to know how to use your investment capital to supplement the money that you will have from superannuation and, perhaps, from working.

Such an ideal poses some questions:

- How much money do we need to be free?
- How do we arrange that money for income?
- How can we continue to work, albeit not so hard or continuously?
- How do we access the capital in our biggest asset—the home?

- How can we maximise the money we have to give the greatest income?

This book tries to answer these questions and show how to use your money to give you the life that you want. It assumes a couple of things:

- That you do have some capital. Nothing comes from nothing and you cannot have financial freedom if you still have to work as you are now. If you aspire to financial freedom you will have to set yourself a target for your wealth (I call it your ‘Freedom Figure’), so that you can live the life of your dreams. I look at how much you need (that is, your Freedom Figure) in Section two.
- That you want to work less and to enjoy a more peaceful and unhurried life. This is not to say that you will stop work altogether. Lots of people happily work and run businesses well into their seventies and eighties. Stopping work completely is not the life of a lot of people’s dreams. Even if you are financially able to live entirely off passive income, you may not want to—there is a lot of joy and a lot of pleasure for some of us in our work.

This is not a book on how to develop the wealth that you need to live the life that you want—there are other books on that sort of thing. However, having said that, I hope it will serve as an inspiration to develop the wealth required to live the life of your dreams. If you do not yet have adequate money to be free, you need to set yourself a target or a goal so that you can continue to work and strive with an endgame in mind. That endgame is financial freedom—

a position where your money is your own and time is your own.

Money is not an end in itself—it is the means that will allow you to live the life you want. My experience is that there are many people who have quite a lot of money but who do not have it properly arranged and invested in a way that will allow them to be free. Sometimes people do not know how to stop, how to say that they have enough—that now is the time to get on and do the things they have always wanted to do. The habit of a lifetime, the habit of building up wealth, can be hard to break. But the number of good summers is steadily diminishing. What follows is how to use your money to make the most of them.

Life in the slow lane

Of all the WealthCoaching clients we have had, Jim and Kate had the clearest picture of the life they wanted. It was far from how they were living when I met them: Jim was a builder and Kate was a theatre nurse. Jim and Kate's children were grown up and off their hands (as far as children can ever be said to be grown up and off your hands!). Jim and Kate had married quite young and had worked non-stop since leaving school. They both worked long hours and found their jobs stressful and tiring. In their early fifties, they knew that time was marching on and they wanted to slow down and start to enjoy themselves more.

Jim and Kate's vision of the perfect life was not retirement. Nor, was it what they were currently doing. Both wanted more time—time for family, friends, hobbies and just chilling out.

Above all, they no longer wanted the rush of work, the feeling that they were never quite in control, never quite had enough time. They wanted to be able to linger over a morning coffee with the newspaper; go for a walk along the river; visit a winery for lunch or spend a couple of hours on the couch with a book. Kate described it best: she wanted every day to be like a Sunday, but with a couple of hours of work thrown in.

Kate wanted to return to her first love—music—and teach piano part time. Jim had an opportunity to do some trades teaching at the local technical college. They had never travelled and wanted to spend a couple of months a year helping in the overseas aid programmes that a charity with which they were involved was operating. Jim also talked about fishing and golf; Kate talked about gardening and learning to ride a horse. Above all, they wanted to relax more, find more time for themselves, for family and friends. They did not want to stop, but they had a very clear vision of what life would be like if they slowed down.

It was my job to help them arrange their money so that this could happen. They were not going to live solely on investment income—they expected to always be in some sort of paid employment. But they needed to work out whether they had enough to allow them to live the dream. As it turned out they did. They were not a wealthy couple, but with some careful planning Jim and Kate could reasonably expect to step out of the rat race and into the life of their dreams. The things that I talked about with them are what follow . . .

Chapter 2 | Making the break

It is hard to make changes. Breaking the habits of a lifetime is never going to be easy. You may have a very clear vision of the kind of life that you want, knowing what changes you want to make and understanding all too well the things you do not like about the way you currently live. You may have a strong feeling that time is slipping away, that now is the time to stop saying, ‘One day I really want to do . . .’, and just do it. Nevertheless, in spite of all of these things pushing you to a new life, it is hard to make the break.

Deciding to work less and live more is a great step into the unknown. For years you have pushed in one direction, a direction in which many have travelled before; you have married, had children, perhaps divorced, progressed your career with good promotions, perhaps developed a business, the children have left home . . . all things that were fairly predictable along a road that is well travelled. Now you have picked up a book about slowing down, working less, rearranging your finances and living a different life. (And not only have you picked the book up, you are reading it!) This is a journey into new territory—territory not so well travelled. And that is frightening. There is no one to tell you what the

terrain in this new place is like, what the traps and pitfalls are, what to avoid and what to seek out. Given all this, it is not easy to move away from the security you have always known.

Well, other people have gone before you, and they have reported that this is not a territory full of snakes, crocodiles and other wild animals. In fact, the terrain is fairly soft and the weather benign—it is actually a pretty nice place. Certainly it is not a heaven full of milk and honey—there are things that can go wrong and traps for the unwary. But working less and living more is not a fearsome place to be.

So what is stopping you? Experience through my WealthCoaching work has shown me a range of things which typically stop people. People do have their ‘buts’—‘I would like to slow down, but . . .’ It is very common for the ‘but’ which they give to be only an excuse, not the real reason for not making the break. Without digging too deeply into a person’s psychology (and therefore moving into an area which is beyond my competence), I sometimes have to work quite hard to find the real objection to taking action.

Here are some of the things which I find have stopped people:

- Money (or more precisely, the lack of it). Many people, even those who are in fact quite wealthy, worry that the money will run out before they do. This is the obvious one, and it is dealt with later in Chapter 7, ‘Do we have enough?’ Suffice to say here that you may not need as much as you think. There is also an ‘enough is never enough’ syndrome (see Chapter 6). Depending on factors like how much you are going to continue to work, the investment returns you can obtain, and the lifestyle you

want, you may well find you do have enough to live the life that you want.

- ‘Stopping work makes people seem old.’ If you think of slowing down and working less as ‘retiring’, you may fear that you will move into a space labelled ‘Old Age’. That is not a great picture to place yourself in. But it is an inaccurate one—just because you have decided to travel more or to work from home is no reason to see yourself as suddenly being old.
- You may be concerned about what family and friends will think. Will they think that you have lost it, that you are no longer up for the game or cannot foot it in the real world? Some people will not care about this at all, others will have to carefully craft a story in explanation of what they are doing.
- Some have no clear picture of what they are moving towards. Most people know what they do not want (a client who is a motor mechanic told me he did not want to have his head under a car’s bonnet any more). However, not only do you need to know what you do not want, you need to know what you do want and have a clear picture of what your new life will be like.
- Some people’s sense of self-worth is tied up in what they do. If, for example, they have been CEO of a large firm, they do not want to become ‘just a consultant’.
- The fear of being bored and/or lonely. There are people for whom work is nearly their whole life: they have friends from work, their work is their vocation and avocation and there is really not much else in their lives. Both their status and feelings of belonging are tied firmly to their work.
- Personal relationships may get in the way. Spouses and partners may want to do different things with their time,

or perhaps one does not want change while the other does. (Perhaps she dreads him being at home all day every day!) At times partners may make assumptions about what the other is thinking and feeling which are inaccurate (for example, he thinks she will never leave the house and garden, while in reality she only puts so much effort into them because there is nothing else to do in Cricklewood).

These are some of the things that stop people reaching out for the life that they say they want. Some of them (in fact, most of them) are easily and obviously answered and fixed. A bit of 'pull yourself together' talk is often all that is needed, although that is not always successful in breaking the shackles of insecurity. Many of the fears that people have are imaginary, being really the fear of the unknown (a sort of grown-up's version of being afraid of the dark).

However, having said that, there are some things that you should be wary of (if not actually fearful of). Some pitfalls which you should watch for are:

- The money really could run out. Being too optimistic in terms of investment returns, having too rich a lifestyle, working less than you expected, or experiencing an unexpected setback like illness or even one partner's death, could make this fear a reality. You do need to approach this change to your life by planning with real assumptions, erring on the conservative side.
- You should know as much as you can about what you are jumping into. This is not a holiday for a few weeks—it is a change of lifestyle which could be permanent. There is an old property investment rule that you should not buy

investment property when you are on holiday. (If you go to the Gold Coast for a couple of weeks, it is very easy to get sucked into buying investment property on the basis of emotions fed by feelings of wellbeing on holiday.) Planning to work less and live more is the same—it needs to be planned by applying a good dose of reality.

- Do not move to a place where you cannot do what you want to. This particularly applies to work things—if you are a marketing expert and hope to get a couple of days' consulting work a week, moving to Cricklewood (where the only business is a general store) is not likely to provide much marketing consultancy work. This is not a problem if you have good contacts back in the city who will happily use your services, but it will be a disaster if you do not have such contacts and need to start from scratch.
- Be very clear on how you are planning to spend your time. Some people who have decreased their workload say that they seem to be rushing around just as much but not achieving what they want. You do need to continue to strive (life is hardly worthwhile if you just vegetate). Set goals, whether they are to get your rock-climbing grades up, your golf handicap down, books read and things learnt, hours of work lessened, etc. Again, this is not a holiday for a few weeks—it is your new life and you're likely to continue to need a good bit of structuring and forward planning.
- Do not get too busy and successful in your work. If you have become self-employed (quite common for people wanting a better life), you may find that you actually get too busy. This is because you forget how to say 'no'. It has happened to me (embarrassingly, more than once) when

I have simply taken on more than I should have. The word 'no' is very simple and you can permit yourself to use it.

When considering how to get over your own 'buts', and thinking about the pitfalls, bear in mind that this change of lifestyle is not (and should not be) a no-exit street. By this I mean that it should be possible to go back to what you were doing previously if things don't work out. You should not burn any bridges behind you, at least until you are confident that what you are doing is what you want. Therefore, keep up with all your contacts and keep your skills current.

Working less and living more is a change to your lifestyle, but it does not have to be a major dislocation in your life. Your life is a continuum and this is another stage in its development, just as when you look back you can see its earlier stages. It is likely that for some of you the new lifestyle you adopt will not be permanent, and that you will move on to other things.

At 52, I still don't know what I am going to do when I grow up—a sort of 'youthful' question of 'what's next?' I left 'work' in the sense of going into an office every day quite a few years ago, and my work for the last few years has been a mixture of writing, presenting and consultancy. However, I think I will probably have another change or two yet, choosing my final career when I consider myself fully grown up. As I look into my future, I see that I still have one—one that I anticipate with excitement.

Chapter 3 | A life of two halves

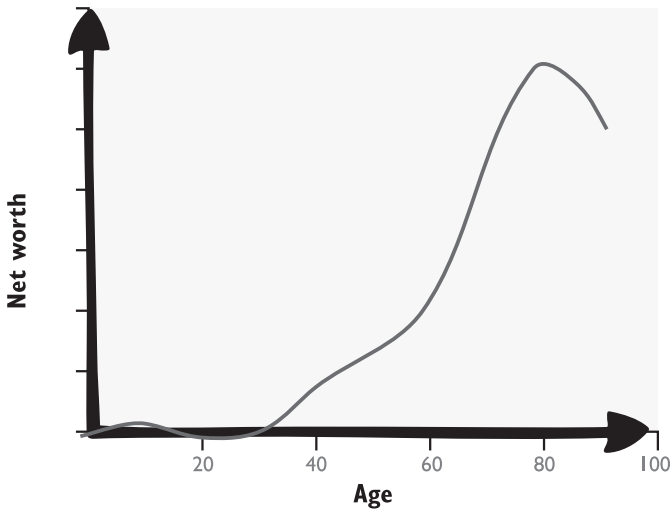
Life, in fact, has many stages or phases. From a financial or money point of view, however, there are two main stages:

1. The first is building up your capital, doing what you can to drive up your wealth. This usually happens from your twenties through to your sixties, with the prime time for wealth creation being in the fifties and sixties.
2. The second is going onto ‘cruise control’ and starting to use capital to give yourself income.

That a financial life is in two halves means that, typically, people’s net worth goes up in the first half and decreases in the second half. Your focus when you are younger is to make yourself wealthy—buying a house, paying off debt and investing for the future. But sooner or later the future arrives and it is time to start to use the wealth that you have built up.

Graphically, this looks like the figure on page 18. This is simply a graph of a typical person’s net worth (or wealth) over the course of a lifetime. If you are like most people, you will start at year zero with no wealth. Wealth may build up a little as a teenager, but then become negative as you borrow

Figure 3.1: A typical person's net worth over a lifetime



for your education. Then, in your twenties, thirties and forties (and maybe considerably later) you buy a house, repay debt and invest, and so build up your capital, becoming wealthier. Your net worth is likely to peak in your fifties or sixties before you ease back and start to use the capital you have for income.

When you look at the graph above, there are more phases than just two. There are the teenage years, the student years, the first years out working, and so on. However, the big phases are the years when you build up your wealth, and the years when you start to use your capital. These are the two halves of most lives.

The thing that is hard for most people is the transition between the first half of your financial life and the second half. You may have spent 30 years or more managing your money with the aim of building up your wealth, and it can be hard to make the change to start spending that wealth. This is a matter of attitude as much as anything else: it can be difficult to let go of what you have created, difficult to see the capital you created starting to reduce. However, much of the purpose of building up capital is to have it to spend when you work less. People save for their futures—it may be hard to admit, but eventually the future arrives.

Not only is a change of attitude needed, but a change in the types of assets and investments you have is also necessary. The change of attitude comes first—nothing will happen unless you want it to happen and believe that it should happen. When you want to stop building wealth and start to use your capital, you have to rearrange your investments and finances so that you own different things in different proportions.

The purpose of this restructuring and rearrangement is twofold:

- **To reduce risk** When you were younger you could afford to carry more risk—in fact, you needed to take more risk to get higher returns. Reducing risk means two things: first, to reduce (or, better still, eliminate) any debts you might have. Second, to diversify more, to spread what you have around a wide range of asset classes and assets. I think many financial advisers take the idea of reducing risk, for people who are wanting to ease back or even retire, too far—some financial advisers suggest owning little

more than bank deposits and bonds, giving no capital growth and no income growth. This is particularly misguided for people in their fifties or sixties. Such people may spend a long time with limited income from work and so need some growth assets (shares, property or a business) to keep up with inflation and to give growth of income. Nonetheless, you will need to rearrange your investments to reduce risk—you are coming to a time in life when you can less afford a major loss.

- **To obtain income** Some investments give more income than capital growth, other investments give more capital growth and less income. When you start to ease back, you need more income than capital growth. This is what pushes some people more towards bank deposits and bonds and away from shares which, as mentioned above, I think is often a major mistake. You do need growth, and it is possible with some thought to live on capital growth (more on this in Section three). However, most people will want to see fairly steady income from their investments in the form of interest, rents or dividends.

A useful way to think of the change in the types of assets that you own and how you structure them is to think of the things you own as belonging in one of two categories: Wealth-Creating Assets or Security Assets. These terms were first used in the book *Get Rich, Stay Rich*, which I wrote with Joan Baker in 2003. It is useful to divide the assets you might own into two categories. If your financial life is in two halves, your investments can be in two halves as well. The trick is to make sure that the right half of your life has the right type of investments.

Wealth-Creating Assets

These are the things that will make you wealthy, assets which will give you a high return (my benchmark is that they will grow your wealth by at least 15 per cent p.a.). The only assets which can give these sorts of returns are a business, a highly geared property portfolio or an aggressively managed share portfolio. The vast majority of people who have become wealthy have done so through ownership of one of these assets.

The trouble is that although these things will make you wealthy, they are both risky and take up a lot of your time. As such, they are suitable for the first half of your life—the half when you want to build up your wealth. Younger people should own a business, shares or property, and manage them aggressively to build up their capital as quickly as possible. Furthermore, younger people should by and large have all their wealth in this area, which means that they are not diversified and have most of their eggs in one basket. They can afford to do this because they have time. However, as they get older they have less time and want to ease back, and therefore have to be more careful. Older people (and that is starting to include Baby Boomers) need to have much more of their wealth in Security Assets.

Security Assets

Security Assets are lower returning investments—but much safer. They are things like the family home (without borrowings), a spread of shares, investment property with low or no borrowings, bank deposits, high grade bonds, a diversified

portfolio across all asset classes, and so on. These are the kinds of things suitable for those who are a bit older, who cannot afford to take as much risk as when they were younger and who are looking for income. Note I am not suggesting that when you have eased back to a new life, everything should be as safe as could be. What I am suggesting is that you will have a lower risk profile and will want to own a quite different set of assets and investments to what you did when you were younger. Security Assets are suitable for the second half of your financial life, a time when you are looking for things which are safer, take less time to manage and from which you can easily take cash.

Making the transition

Although it is useful to categorise assets and investments as those for the first half of your financial life, and those for the second, and to recognise that some are suitable for younger people aggressively building wealth while others are suitable for people who live off their wealth, the division between the two is not really so neat and clear-cut. Nor indeed are the two halves of your life neat and clear-cut. Our parents' generation may have retired neatly at age 65, so that between one day and the next, everything was different. They stopped work and started living an entirely different lifestyle requiring entirely different finances.

Our generation is likely to be quite different. Rather than suddenly stopping work because we have reached some arbitrary age, most of us are likely to gradually wind down, perhaps taking a couple of decades to do so. We may start to

work less and ease back at the age of 55, but continue to work in some capacity or other through to the age of 75. Your finances may be the same: there is no need to choose a particular day on which you sell your Wealth-Creating Assets and buy into Security Assets. Your life situation is not going to change rapidly and therefore your finances need not either. Your finances should change only gradually, reflecting the lifestyle changes you are making.

An example of this is people who own a business (a typical Wealth-Creating Asset requiring a lot of time and carrying quite a lot of risk). If you simply wanted to retire, you could sell the business on your 65th birthday, and use the proceeds to purchase Security Assets. Another option, however, is to identify someone who will ultimately own the business (perhaps a family member, a staff member, a supplier or someone else in your industry) and sell a percentage of the business to this person. Initially, you may sell, say, 25 per cent of the business to this person—and ideally you would give up some of your management roles to him or her. As time goes on you can sell more of the business to this person, gradually relinquishing both ownership and management control.

The advantages of doing something like this are:

- You reduce risk as you sell down;
- You continue to get some of the profits from the business, likely to be a very good return on your capital;
- You reduce your workload gradually—you will have reduced responsibility while still having an interest in the business;
- The person who is buying in has time to learn from you and grow into a management role; and

- You are not trying to sell at one particular time, which might prove not to be a good time to sell a business.

Gradually selling down or discontinuing what you are doing works for the other Wealth-Creating Assets too. You can slowly sell some of your aggressive shares, putting the proceeds into a more diversified portfolio of shares; you can restructure your investment properties, perhaps by selling some and using the proceeds to repay debt on the others you continue to own. This does not need to happen all on one day—in fact there is every reason why it should happen gradually over a few years.

The key is to have a plan for the transition—to know where you are going and how you are going to get there, knowing what you want to own at a certain point in time and working towards this. Plan for how you are going to move from owning aggressive Wealth-Creating Assets to more passive and less risky Security Assets. You do need to reduce risk—but you do not need to do it overnight. You are moving on to the second half of your life and one day your finances will have to reflect that. To ease back and live the life of your dreams, aim to rearrange your finances to reduce risk and the time that you have to spend caring for things like the business, a property or share portfolio.

Reuben and Glenda had spent twenty years building up their wealth through property investment. They had bought flats and apartments whenever they could afford to, continually using their growth in value to raise more borrowings so that they could buy more. When I met them they were in their

mid-fifties and getting pretty tired of tenant and maintenance hassles. It was time to ease back.

Reuben and Glenda owned nearly \$1.5 million worth of property which had a little over \$600 000 of borrowings. The portfolio was cash flow positive, but only just. The couple had to drive it fairly hard, making sure that they kept vacancies low and maintenance up to date.

Their first thought had been to sell everything, repay debt and to use the funds left over (probably around \$900 000) to invest in managed funds and the like. They had been told that this was what they should do but they were reluctant because they knew nothing about managed funds and, like many property investors, mistrusted them. The mistrust was not their only problem—Reuben and Glenda also did not really know what they were going to do with their time. An energetic couple, they were hardly going to buy rocking chairs and sit in them for thirty years waiting to die.

The solution to this was to sell down two of their flats and repay debt so that they had something less than \$100 000 of total debt. With the retirement of around \$500 000 of debt, the properties would be strongly cash flow positive and the cash flow could be used for the next five years to reduce indebtedness to zero. At this point, they would have approximately \$1 million of property with no debts. They would continue to run the properties, putting in professional managers when they needed to.

Chapter 4 | Arrange (and maximise) your business

Many people have become wealthy through their business. A business, in fact, is probably the most common (and effective) Wealth-Creating Asset there is. A business is a little like a house—it often makes up a large proportion of a family's wealth. A business may be built up over years and decades and can finish up being very valuable (sometimes far more valuable than the owners realise). Some people end up owning a valuable business, a house, and not a lot else. How you handle the business when you make a change in lifestyle—whether you simply sell it (and, if you do, at what price) or do something else with it—the decisions you make can make a big difference to how well you enjoy your next summers. You need to think about taking very good advice, and setting a long-term plan for what will become of the business.

When I talk about a business here, I mean a 'real' business. I am not talking about self-employment, about working as a self-employed consultant or tradesman. I mean something that can be sold. A self-employed management consultant might consider himself or herself 'in business', but the reality is that such a person is self-employed and will probably have nothing to sell when the time comes. So in effect they are

little different from a wage earner or salary worker. The same management consultant could, of course, take on staff, build up a reputation and brand, develop a large and loyal client base and thus in the end have something to sell.

Building up a business with value is a very good way to become wealthy, and lots of people have done it very successfully. As such it is a very good Wealth-Creating Asset, but it is not a good Security Asset. This is because:

- It is a large undiversified asset, and therefore quite risky;
- It is likely to have borrowings;
- It takes up a lot of time—most business owners live, eat and breathe their business, putting a huge amount of time, effort and energy into its development and management.

It is very hard (although not impossible) to have financial freedom and ease back while you own a business. Your time is not your own, and your money is not your own (businesses frequently have quite high borrowings). It is hard to have passive income from your business. They certainly provide very good active income, but you are wanting to be less active so that you can do other things.

The first thing you have to recognise is that you will not own the business forever—one day it will either not exist or be owned by someone else. You cannot take a business with you when you die. The question is: who will control the process of succession to someone else, or will it happen in an unplanned, uncontrolled way?

The identification of who the business will succeed to, and the timing of the succession, is critical for business owners who want to change and live a better life. This is not

something that you want to do on the spur of the moment—it is a process which needs to be planned well in advance.

If you own a business and are ready for a different life, you have some basic choices—sell the business, put managers in, or sell a part of it.

Selling the business

This is in some ways the most straightforward option. It is simple insofar as you swap the business for an amount of money and you and the business go your separate ways. However, the idea of not owning it can be disconcerting—it represents a major life change. You may worry about how you will spend your time, even though in all the years of running the business you have craved more time. You may also be worried about how you will live without the income that came from the business. This last concern is most easily answered: you are swapping the business for some cash which you are going to invest (you are not, after all, going to give the business away). You may need to learn new skills (particularly investment ones) and you will need to learn a new lifestyle, but that was what you were wanting! Remember that lots of people have gone before you—you are by no means the first person to have exited a business for a new life.

One thing people often say to me when we are talking about the sale of a business is that they get such good returns from it compared to the income they are likely to get from the sale proceeds. This is of course true—you are unlikely to find an investment which will give the same financial returns. However, there are two things that you have to bear in mind:

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1. Part of the return you get from the business is a return on your time. Many business owners draw a salary to an amount that is efficient for tax purposes but does not truly reflect what they are worth. When you put a full salary against the profits from the business, the return is not so good.
2. Owning a business is risky—many small businesses fail. Owning a business means you have a great deal of money in one undiversified asset. Moreover, not only is it undiversified but it is also illiquid—you cannot sell it on short notice as you can with a lot of investments. Thus while the returns from businesses are high, so also is the risk.

Selling a business is not always easy—you will have to show potential buyers all aspects of it, and things that were previously private and confidential become known to strangers. A client once described this experience as akin to taking off his clothes and standing naked in the local shopping mall! It is something that you should be prepared for well in advance. Buyers must be identified and the business must be in good shape. In my experience, the buyer for your business is likely to be someone who already has some sort of connection to it—a customer, supplier, competitor or staff member. Certainly, you can sell it to some unknown member of the public, but this is often more difficult as you have to start from scratch.

Putting in managers

The returns from your business are likely to be so great that it is tempting to keep owning it, hiring someone else to manage

it. The theory goes that you take a director's (or governance) role while a professional manager does the day-to-day work, that you get to choose some interesting aspect to work on while not having to do the daily grind, and also get the high income returns.

Although this sounds very good in theory, it frequently does not work out as neatly as planned. Things do go wrong in businesses, and when they do you will have to get involved. This may mean that you get called back into management, which results in your essentially being back in full-time work. Furthermore, you still have all the risks of owning the business. Unless you have other significant assets you will not be well diversified and so will be very exposed financially if things do go wrong. Putting in professional managers and treating your business as if it was some kind of passive investment may be a very tempting idea, but you must be aware that there is plenty that can adversely affect both your financial situation and your lifestyle.

Selling part

This is often my preferred option. It involves selling down a part of the business, and then, all going well, selling more (usually to the same person) over time. There are a number of advantages to selling part of a business:

- You continue to receive some of the profits and capital growth of the business—likely to be a higher return than you will get from other investments.
- You will not have to be involved in the daily grind, but will still have an overall watch over the business.

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- You will have some cash from the sale to pay off debt and to buy some diversified investments.
- It opens the sale up to a wider range of people. If you are selling all of the business, only a limited number of people are likely to have the money and the skills to make the purchase. Selling down a part means that the new part-owner needs less capital and can be trained.
- You are developing someone who will likely be the full owner of the business in time (perhaps a family member).
- The business may become more successful than it was, as the new owner gives it a new lease of life with his or her energy and different skills and contacts.
- You can steer the business to a good future with the satisfaction that the business will continue.

There are also some risks and disadvantages, however:

- The new part-owner may not work out. You may end up having to buy him or her out.
- You may have disagreements about the future direction of the business.
- You may find that you are drawn back into the business when problems arise and have to do as much work on it as you ever did.
- You are not wholly free of the business to get on with the other things that you want to do.

The solution to most of these problems is threefold—find the right person, have a good agreement and sell down progressively. Even if the person you sell to is someone you know,

you must have a proper legal agreement drawn up—the same sort of agreement that you would insist on if the party involved were a stranger. Finally, move slowly. Sell perhaps 20 per cent initially, and only sell more if things are still going well in, say, a couple of years. Although your aim may be to sell the entire business, the whole process could take ten years or longer.

The story of a client I had some years ago illustrates how selling a part of the business can work. Theresa had owned and managed her business for over twenty years. She had started it from scratch, but at 58 she knew it was time to consider succession and to start doing the things she wanted to do (especially travel and community work). Theresa admitted to me that she was getting tired of the business—it no longer energised her to the same extent as when she was younger. She knew she could sell her business to a competitor but she did not really want that to happen: she loved what she had created, feared for the jobs of her staff if the competitor owned, it and was not terribly interested in learning how to invest the proceeds if she sold out completely.

After some discussion we identified one of Theresa's employees as being capable of running the business. Karen had been with Theresa for six years, and at 37 was her lead consultant and already had a sales management role. Karen had a few skill gaps (especially in finance) but nothing that she could not learn.

Karen immediately expressed interest when she was approached. Her main problem was that she had no ready capital. The company was valued at \$785 000—it made before-tax profits of just on \$200 000 p.a. after all salaries.

To own 20 per cent of the shares, Karen would have to find nearly \$160 000.

Karen could borrow an extra \$100 000 on her house. Because she would become general manager of the business, she would receive extra salary of \$20 000 p.a., and this would cover these borrowings quite comfortably.

The balance of \$60 000 would be funded by Theresa—a sort of vendor finance. A dividend policy was agreed under which Karen expected to receive \$20 000 p.a. in dividends with which she could pay off the loan from Theresa. Theresa told Karen that provided the business was performing well, when the loan was repaid she would discuss the sale of more shares.

Theresa's role changed from owner and general manager to director and half-time consultant. Her salary dropped from \$90 000 to \$40 000 p.a. plus an annual director's fee of \$10 000. In addition she would receive her share of the dividends (\$80 000). The \$100 000 Theresa received from Karen as part-payment of the shares was used to pay off her small mortgage, the balance being put on term deposit with a bank. An independent director was appointed—an accountant, to help with Karen's lack of finance skills.

In a few years' time, all going well, Karen will be able to buy more shares in the business, using the extra dividends she would receive to service a loan. Theresa at that time will have more money for the bank—she never had any intention of learning about investment and doing anything better with her money. A job as a consultant would always be there if she wanted it, and for perhaps ten or fifteen years she would continue to receive dividends.

It may take you years to completely exit your business. A spur-of-the-moment decision followed immediately by action is likely to leave regrets—less money than you could have got and few ideas about what you are going to do next. The selldown needs to be planned well in advance, buyers identified and the business prepared. Take your time and take advice—how you arrange your affairs may be the key to how much you can enjoy all those good summers to come.

Alex was a client of mine back in the olden days (mid-1980s). When I met him, he had owned his business for over thirty years. In his mid-seventies, he still enjoyed running it but recognised that now was the time to get on and enjoy the things that he told himself (and his wife) that he wanted to do (especially travel). He wanted to sell and with his health not terribly good, he wanted to sell now.

Alex came to talk to me about how to go about selling. He was in importing and had a number of very good, exclusive agencies. The business was very saleable and was clearly going to fetch a big price (certainly Alex and his wife would have no financial worries). We talked around a few ideas—the business's value and who the buyer might be. Alex went off happy to talk things over with his wife.

Six weeks later he came back to see me, less than happy. The government had just announced a major relaxation of import licensing, and reductions in tariffs and duties. Alex still had his exclusive agencies, but competition was looming already, the economy was sour and the prospective buyers from within his industry had evaporated. Nevertheless, at his age and with his health problems, he still had to go ahead

and sell. (He told me that if he was younger he would have tackled the competition head-on and beaten it.)

Alex ended up getting only a fraction of what we had thought he would get for the business. He got a small amount of money for someone to take over the agencies but aside from that he got only what he could sell his stock for. By the time he repaid the business's borrowings and the debt that was secured on the house, his financial position was poor. While his situation was partly bad luck, it taught me that having your business as the only egg in your basket as you got older was not a good idea. It also taught me that you cannot be committed to the sale of a business at any one point in time—you have to have some flexibility as to when you will sell.

Chapter 5 | The importance of work

When I got into the taxi at the airport, the driver immediately recognised me. He had read a book of mine on property and for the 30-minute drive into the city he had me captive. I like talking to taxi drivers (they know what is going on better than anyone else). He said he had rental property, and what did I think of the market? I guessed he was well into his sixties, and I imagined that he probably had a small flat somewhere and might have been thinking about cashing up.

As we chatted, however, I realised my assumptions were all wrong. He did not own just one property, but six. When I asked if he had his mortgages on fixed rates, he just chuckled and said he had no borrowings. Then he started talking shares—he clearly had a decent sized portfolio. So I asked the obvious question: ‘What are you doing driving this cab? You don’t seem to need the money.’

The answer was simple and complicated at the same time. The cab was owned by his son-in-law, who worked nights. My driver drove four, fairly short, days a week. It got him out of the house, he said—much to the relief of his wife, who had been forced to ban him from watching Test cricket. He met people, found out what was going on and, chuckling again,

every now and then got himself some free financial advice. It turned out he was 72, and far from ready to put a shawl over his knees and sit in a rocking chair. He had been a factory manager, and when he retired found himself so bored that he gratefully accepted the offer to drive his son-in-law's cab. No, he didn't need the money, but he did need the focus and the interest of getting out and meeting people, and the feeling of doing something useful. I should have given him a big tip—he had taught me (yet again!) not to make assumptions.

'Work' is a strange word, not always with good connotations. My dictionary says that it means 'to be occupied by a business or employment'. But it also says that it is 'effort directed to an end'. Mine is an old dictionary (a gift for passing an exam in 1971), but I like that second definition. I don't think that we are wired up to do nothing—I think we are wired up to strive for something, to put in effort for some kind of end result. We need a goal, and when we reach that goal we need another goal. People without goals of some sort stagnate—we need goals to continue to grow and be better.

The problem with 'work' is that we usually think of it as the daily grind. It is what we have done for years as we have run a business or answered to a boss. It is what we want to get away from—it has stopped us from being with our families, playing golf, being in the garden or out fishing. We think of it as what we have to do to put bread on the table—and the fact that we *have* to do it (compulsion) makes it very unattractive. But think of the alternative: doing nothing. Even playing golf or being in the garden every day will only go so far. How much fishing or rock climbing can you do?

In any event, experience has shown me that people do want to strive, to put in effort towards a meaningful end.

Even the people I know who are very, very wealthy do not do nothing, or even dedicate the rest of their lives towards a lower golf handicap. I have never had a client who has thought that on becoming wealthy they would spend the rest of their days pursuing hobbies and pastimes. (Another interesting word, ‘pastimes’. Why would we want to do things that simply pass the time? Time is, after all, the most valuable thing that we have—why would we want to do something solely to make our most valuable asset pass more quickly?)

You may have only twenty good summers before you reach your three score and ten. There may be things you are burning to do. But these things don’t have to preclude ‘work’. Whether that work has to be paid work (because you need the income) or can be unpaid (for example, helping somewhere in the community), you are likely to want to strive for something. If it can be unpaid, you are still likely to want to do something like mentoring, helping an aid project or directing a business.

If your work has to be paid work, there are options. Do not let all those negative thoughts about work get in the way. It does not have to be the thing that you have done for 50 weeks a year for the last fifteen years. If you have to be in paid work, you are very lucky to be living in the 21st century:

- What you know (experience) is now more highly valued than what you can do with your hands.
- There are shortages of all sorts of knowledge workers, teachers, mentors and instructors.
- There are anti-age discrimination laws.
- Employers are more flexible, allowing for part-time people.

If you have to work because you need the income, you will have lots of company. The real secret to planning how you are going to live is to think beyond the work you are doing at the moment. What you are doing at the moment may be very unattractive—and you may want to stop. If you think that you can only do what you have always done, you are probably right. But if you think beyond what you have always done, if you think of the skills and the experience you have you may see that there is a great deal more that you can do. To ease back requires a stocktake—of what you want out of life and of what you own (that is why a net worth statement is so useful).

You also need to take stock of what knowledge, experience and skills you have, which are quite possibly far greater than what you think. There is not too much that is good about getting older, but one of the good things is experience—you will have done a lot of things and have a broad perspective. It may be that you can do something quite different when you start to ease back. You may not have to continue with what you have always done—there may well be something much more interesting and completely different that you can do part time. Your knowledge, skills and experience may cross very easily into other industries and other occupations. It is said that a change is as good as a holiday—if you need to continue to earn income, a change of job might be the break that allows you to stay engaged.

If you are trained in some knowledge area of work (or able to retrain so that you can become a knowledge worker), you will not have to do the physical work which we all find harder as we get older. Not only will you be paid more, but you will be able to work for longer. Think of it this way: if you are

currently earning \$50 000 p.a. and are planning to work for another five years, you can afford to work part time instead and earn \$25 000 p.a. for ten years. That is a very attractive idea—it means that you can make changes now, earning income perhaps half of your time with more time to do the other things that you want with your summers (although committing to work for longer). This is one of the very good things that the modern world offers us—the ability to keep earning and stay actively engaged in society, continuing to be usefully and gainfully employed.

I have found that quite often an employer does not want to lose a particularly valued employee, and will bend to accommodate a desired change of lifestyle. One of my clients had been a long-term employee in a middle management job. The client told his employer that he was planning to leave in the next few months to work in a completely different industry part time. The employer was alarmed at the prospect of losing my client and within a few days offered a role in the business which allowed him to choose his own reduced hours. I know several people who have tried to resign from senior management positions in companies based in capital cities because they wanted to move into the country. In each case their employer has bent over backward to accommodate them, allowing them to work from home by email and phone, to travel in as needed a couple of times a month. It has to be acknowledged, however, that this sort of arrangement does not always work well—the employee sometimes finds that he or she is travelling a lot and has all the stress that went before, and then some.

Many people are just one skill away from being able to do something quite different. The missing link might be

computer skills, sales skills, accounting skills—you name it. A good example of this was a friend of mine, a builder. In his late forties he was starting to find scrambling around building sites, putting roofs on houses and carrying heavy loads quite tough. When he learnt spread-sheeting he found that he was very useful in the office doing pricing and quoting. He could not have done that without the additional computing skills, but a three-week course transformed him from a builder doing heavy work to an office worker still in the same industry. You should treat any course that might help to fill a skill gap as an investment—it may cost a bit of time and money (particularly if it is a longer course taking a year or two), but it will let you earn more income for longer. Think about any changes you are going to have to make and the training that you might need as early as possible. Some changes you may need to make have quite a long lead-time—you do not want to go cold turkey.

Becoming a consultant can be an option for some. After a lifetime of being employed this might be a bit scary—you have to be very confident that you will be able to find the clients. However, many people leave employment knowing who their clients are going to be (often the main one is their previous employer). Consulting also allows you to work the hours you want. You do need to be careful how you charge for consultancy, however—many people undercharge. Remember that the hours you can charge out are not the same as the hours you have to work: as a self-employed consultant you will have to spend non-billable hours marketing and selling services, putting in systems and looking after the accounts. You also have to look after your own sick leave, holidays, other downtime and costs. This means you should probably

charge around double the hourly rate that you were getting as an employee. If you have been earning \$30 per hour, you should be charging at least \$60 per hour as a consultant—more if you can get it.

Some people find that they cannot ease back as a consultant—the requirements and strains of being self-employed sometimes turn out to be harder than being employed. Having to get out and sell, pay compliance costs and do things like book-keeping and debt collecting can add up to working at night and at weekends. I have known people who have tried to work less as a consultant but ended up working harder than they had ever done in their lives without earning as much as they used to. For every billable hour you are budgeting for, you will probably spend at least one working hour that you cannot charge for. For example, if you are needing \$2000 per month to make your lifestyle work and you charge out at \$100 per hour, you will need 20 billable hours per month. But you will not work only 20 hours per month—it is likely to be nearer 40 hours at least, and often considerably more. Being a consultant can be a very good option, but it needs to be planned with a sense of reality.

It's unlikely that you will want to sit around and do nothing—when people define themselves by what they do, doing nothing means they are nothing. Certainly, you will want to spend more time with the family, travelling or engaged in hobbies. But none of these things precludes work. You can work part time, using the income to supplement what you get from investments and superannuation. The negative connotations of work are as much a state of mind or an attitude as anything else. You may want a break between leaving your full-time job (or selling a business), but your

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plans to ease back can very easily include some income from employment. Think creatively—the skills that you have will cross over into other areas and other occupations. You can drive a taxi, be a consultant, do the accounts for some small businesses, teach organic gardening, restore cars, do flower arrangements for reception desks, coach maths to earn money, and still have the time to do the things you have always wanted to do.

Chapter 6 | The 'enough is never enough' syndrome

I have seen it over and over again: people grossly overestimating how much wealth they will need to live comfortably on their investments. Many people think they need a lot more capital to fund their lifestyle than they need in reality. The 'enough is never enough' syndrome has you always looking for more capital and always feeling that you never have quite enough to change to the life you want to live. The reality may be that you are a lot closer to freedom than you think.

There are probably three things driving this syndrome:

1. Feelings of insecurity. This is rational enough, in that we are biologically programmed to ensure we do not run out of the wherewithal of life. The basic fear that our money will run out before we do can drive us to keep working, keeping on building up our wealth to an extent far beyond our true needs.
2. There is a whole industry out there trying to encourage us to save more and to keep on saving. Far be it for me to encourage less saving and investing (I have basically made a career out of helping people to do so), but I do see many professional advisers and commentators frightening people

into saving by suggesting that you need bigger amounts of savings than I think are really necessary. I have seen it suggested that you need savings 25 times the amount of tax-paid income you want—this commentator was therefore implying an investment return of just 4 per cent.

- Fear of change. Some people are fearful of changing their lives and so keep on working or running their businesses, telling themselves they do not yet have enough. This is clearly an excuse psychologically designed so the person does not have to make changes to their life and lifestyle. I have no problem with people not wanting to change if they are happy with their lives. But when people who are saying they don't have enough (when with a bit of planning they really do) are also saying that they are sick of their work or their business, I do see a problem.

Many of the people who say they don't have enough, or who set a very high estimate of how much they need, have never done any kind of exercise to plan how they would use their capital to live on as income. Nor have they ever made any kind of calculation to work through the numbers. Their assessment of how much they need is based on a number they have simply plucked out of the air (the 'think of a number and double it' approach to financial planning). You may never be able to make an exact calculation of how much you need (and you should always add a bit more than the numbers suggest to make quite certain you will have enough), but that should not stop you doing at least a few basic numbers and estimates. Section two of this book is designed to help you make this calculation.

The reality is that you are likely to need capital of around 10–12 times your desired income, rather than 25 times.

There is wisdom (and a better life) in being able to say that you have enough—that you do not have to keep striving for more. You could be a lot closer to freedom than you think—indeed, you may already be there.

Patrick and Mary owned a very successful business. They were in their late forties and had owned and developed it for over twenty years. Their business was highly profitable and very valuable—a competitor had been trying to buy it from them for years.

Patrick and Mary's problem was that they hated the business. They had never much liked running it and after twenty-odd years of long hours they were fed up.

I calculated that Patrick and Mary would need around \$2 million in capital to give them the passive income they needed to live the life they wanted. When we valued the business it was apparent that it was worth over \$4 million (the competitor had offered \$3.5 million the year before). Patrick and Mary had a net worth of nearly \$5 million and needed less than \$3 million to live the life of their dreams.

I could not see what their problem was. 'Let's sell the business now and get on with the life that you want,' I said.

Patrick immediately folded his arms across his chest and shuffled uncomfortably. 'No, \$5 million is not enough—we need \$6 million,' he said. Clearly this was not true (we had done the numbers) but he was unshakeable.

I have never really found out what was stopping Patrick and Mary from making the break. In spite of what Patrick said, it was not money. Eighteen months later, they are still running the business, still hating it and still saying they are going to sell when they 'have enough money'. I doubt that 'enough' will ever be enough.

Section | 2

Setting things up

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Chapter 7 | Do we have enough?

The title of this chapter says it all. It is a question that many of us ask ourselves: we want to step back and have an easier lifestyle, we want to start doing the things we have always promised ourselves we will do. But years of trying to get ahead financially have created an ingrained habit of striving for more savings and investments. Now, perhaps in our forties, fifties or sixties, we are asking ourselves: Have we made it? Do we have enough?

It is really one of the fundamental questions of human existence. We expect there to be a future (hopefully a future that will span more than twenty summers) and we want that future to be secure. Change is always difficult, and the sort of change that you may be contemplating to your means of support can be downright frightening.

The answer to the question ‘Do we have enough?’ is not straightforward. For most of us, it is not simply a matter of looking at how much we have in savings and investments and working out an answer on a calculator. There are eight major factors or variables that have to be looked at, and their mix played with and adjusted until there is an answer suited to our future life and lifestyle. These eight variables need to be

considered in turn, and decisions made regarding most of them to allow you to create a plan that will let you build a new, more relaxed and more peaceful life with financial comfort.

The eight main factors you need to take account of in developing a plan to reduce your dependency on paid work and to have more time, are:

- The amount of capital you have;
- The lifestyle you want;
- The house you want;
- Whether you want to leave an inheritance to your children;
- The extent to which you will continue paid work, and for how long;
- Any other income you have;
- Your age (and therefore how long you expect to live); and
- Your investment returns.

Each of these eight factors is dealt with in detail in chapters 8 to 15. Suffice it to say here that unless you have a quite high net worth (and therefore a lot of capital available to invest), it is likely that you will have to alter your expectations of some factors and continue to readjust them until you get a plan which gives you the amount of money to fund an acceptable lifestyle. For example, it may be that you want to work only three days a week for another five years, then stop work completely. This may have the result that your income will be too little later on, and so you will have to trade off one of the other factors (for example, reduce the lifestyle you want, downsize the house or perhaps decide to leave a lesser inheritance to the kids).

Life is all about trade-offs—none of us can have absolutely everything that we want. You are starting to plan for a new phase in your life, an exciting process for an exciting new life. However, the plan will probably not fit together neatly at first—you will have to compromise on some and trade off between other factors. In other words, you will have to decide which of the eight factors are more important than the others—which can you give up on and still be quite happy? Such a process is almost inevitable for all but the wealthiest people (or those who have extremely modest needs).

The answer to the question ‘Will we have enough?’ is part calculation, part judgment—part science, part art. The calculation side works for some of the eight factors discussed in the following chapters (for example, how much income you need for your lifestyle, how much capital you have at the moment) but other factors are a matter of judgment (how long am I likely to live, how long will we enjoy doing some paid work). You will never be able to answer the question precisely—you have to make some guesses. You are making a plan for the future and few plans for the future ever work out neatly according to the script.

Moreover, as you look at each factor you may well have to adjust some of the things you want less so you can have the things you want more. This is not a plan where you can make all the pieces of the puzzle fit and stay fitted for all time. Rather it is a plan of continual judgments and trading off one item against others.

And so back to the question: Do we have enough? What capital do you need to be able to do less (and earn less) and still have the confidence that the money will not run out and you will not have to spend your days in poverty or penury? What

figure do you need to enjoy freedom? Do you have enough? How much is enough? When we have WealthCoaching clients, one of the early things we do is help them establish a Freedom Figure—the amount of money they will need in order to live off their capital in comfort and with some confidence that they can enjoy the lives of their dreams. In WealthCoaching, the Freedom Figure becomes the goal the client is working towards—the amount of net worth needed to fund the lifestyle they want in the future.

The Freedom Figure obviously varies from individual to individual, but the amount of money required to be free is very often a lot less than people realise. We have several times found clients who say that they want to increase their wealth but who in fact already have enough! These clients told us they were looking for ways to increase their incomes and their wealth, but in fact they could forget about doing that and start to enjoy the lives of their dreams.

Generally, I work on the Freedom Figure (the amount of investable capital you will need) as being approximately 10–12 times the amount of the before-tax income you need. This is a very rough rule of thumb, but means that if you wanted before-tax income of \$50 000 p.a. you would need investable capital of something like \$500 000–600 000. There are ways and means of freeing up the capital you need, whether from your house, your business or from your investments, so that you can apply that capital to income-producing assets which will allow you to live a life of freedom. This is an exercise that you will have to do—to have the freedom to take maximum advantage of the next twenty summers, you need to know how much capital you need to generate the income returns required.

This rule of thumb figure of the capital required being 10–12 times the before-tax income you want, is much less than some other financial advisers suggest. As I mentioned earlier, an article I read recently suggested that you need capital amounting to 25 times the amount of income that you want. Another financial adviser I met a decade or so ago said that people need capital of around 20 times the income required. These higher figures are not great news for those of us planning to invest our capital to get income returns on which we expect to live. If you had to plan to have capital 25 times that of the income required, you are obviously going to require a lot more capital than if you follow the 10–12 times figure I use.

To say that you need capital amounting to, say, 10 times the income you want is to say that you are anticipating an investment return of 10 per cent; to say that you need capital amounting to 20 times the income required is to say that you are anticipating an investment return of 5 per cent. There is a great difference! A 5 per cent return can be had as easily and as safely as putting your money in the bank; a return of 8–10 per cent will require some more skill, a bit more risk and perhaps some professional advice. Nevertheless, an investment return of this magnitude *is* attainable! And it is attainable with a degree of risk that would be quite acceptable for most people.

When you have an indication of the returns you might get on your capital, and assuming you know how much income you require, you can easily calculate roughly how much capital you need. The amount of capital you need is found simply by multiplying the income you want by the inverse of the return you are likely to get. That sounds like a mouthful, but it is in fact quite easy.

For example, you may want income before tax from your capital of \$20 000 p.a. to supplement the other income you will have. If you thought that you could get a return of 8 per cent, you would multiply the income by 12.5 (which is the inverse of 8 per cent). That would mean you would need to have capital of \$250 000.

To get income of \$20 000 p.a.

Investment return	Inverse	Capital required
4%	25	\$500 000
6%	16.7	\$334 000
8%	12.5	\$250 000
9%	11.1	\$222 000
10%	10	\$200 000
12%	8.5	\$170 000

Note that the figures in this example do not account for inflation—they assume that you will be happy with \$20 000 income each year for the rest of your life. That is, of course, unlikely—the spending power of your \$20 000 p.a. will erode over the years. However, inflation can be compensated for in a number of ways: you can live on capital to some degree, and if you invest in some growth assets (shares and property), your income is likely to increase over the years.

Few people live entirely on income derived from their investments. If you want to step down from full-time work to enjoy more fully some good summers, you do not have to plan to live solely from your investment capital. Many people would find they simply do not have enough to do so, and thus would have to stay at the grindstone for many years yet.

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The income you need does not solely depend on how much capital you have. There are other factors at play (for example, the extent to which you will continue to work, or other income you might have), and the plan you develop needs to take account of them all.

It is quite possible that you do have enough. Time and time again I have found people feeling less financially secure than they really are, a feeling which stops them making the changes in their lives they say they want to make. Quite often they have not done the numbers, not started to do any sort of planning, not thought through how they would live if they cut their working lives to some extent. My conclusion is that people often feel more comfortable keeping on doing what they do even when they say they want to stop doing it. It is often easier to keep on with the habits of a lifetime than to move towards something that is likely to be better. Change can be very difficult.

The farmer, the chickens and the eggs

The distinction between income and capital is critical to understand. In Accountancy 101 they teach that capital is the tree and income is its fruit. I prefer to think of capital as a chicken and income as an egg. The egg (income) is derived from the chicken and provided that you do not eat the egg it will grow to become another chicken and eventually start to produce even more eggs. Similarly, you could eat the chickens (capital) that you have, but if you do this, they will not produce as many eggs (income).

Think of a chicken farmer who does nothing else but run his farm of thousands of laying chickens. Clearly the farmer

will live on the eggs that his chickens produce. Provided that he has enough chickens laying eggs for him he can consume some of the eggs and keep some to replace his laying stock. If he has enough chickens laying enough eggs to give him good nutrition and to replace the chickens that will inevitably die or stop laying, all will be happiness. He has a sustainable chicken farm off which he can live happily (albeit a bit boringly—all those eggs and nothing else).

However, if he does not have enough chickens laying enough eggs to sustain him he has to think of some others ways to get by and feed himself. One of those options would be to leave the chickens to themselves for a couple of days a week and get a job on a neighbour's chicken farm (where he would be paid in eggs, of course). The eggs from his own chickens and those from working for his neighbour part time ought to be enough to sustain him. It might even be that he has a small surplus and can keep a few eggs to hatch into chickens and so one day have a farm which is completely self-sustaining.

The other option would be to supplement his diet of eggs by killing and eating a few chickens. Long term, of course, this is not sustainable—the more chickens you kill and eat, the fewer eggs you are going to have. However, long term it is possible that living in part off eggs (income) and in part off chickens (capital) is an option (provided that you get the timing right and the chickens do not run out before you do).

The real point of all this is that if you are planning to live more and work less, your objective is much less likely to be the building up of a big flock of chickens than finding a way of producing more eggs for consumption. I am no expert on chicken farming, but it seems likely to me that the type of

chicken you will need to produce eggs for consumption will be a different breed from the chickens you will need to produce eggs for breeding and building up a flock. This is certainly the case in investment—the types of investment assets that you own for income will be quite different from those you have for capital growth.

As well as this, remember that you do have the option of living off capital if you need to. This is effectively supplementing your diet by killing some chickens. It is not sustainable long term but it could keep you going for the time that you need it. In any event, in the long term you will not need the chicken farm—you won't be able to take it with you. In the meantime, you can enjoy a great diet (and life) living off your capital stock.

The next eight chapters look one by one at the eight factors you need to consider when asking the question 'Do we have enough?'

Chapter 8 | Factor one: how much capital do you have?

To answer the question ‘Do we have enough?’, you need to know first how much you actually have. How much capital you have is obviously one of the factors in answering the question. If you are going to plan a journey, you need to know where you are starting from. In financial terms this means taking a snapshot of what you have. You could see this as doing a stocktake—looking at what you own (your assets) and deducting what you owe (your liabilities)—to get a picture of your net worth. Looking at your net worth is one of the most important parts of planning for your freedom. Before making any plans, you need to know what you have to work with.

For many people, the use of income from savings and investments to help fund a new lifestyle will be a critical part of the plan. To be free, you need your investments to provide income. In some cases this will be the only income you have to live on, for others it will supplement income from other sources. Investing for income to help pay the bills will no doubt be a significant change from the way you have previously invested—you will stop trying to build up wealth, instead finding ways to maximise the income from the wealth you already have and using that income to live. A strategy for

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wealth creation is necessarily quite different from one that seeks to maximise income, so your money will now be invested in different areas. Using the capital you have built to derive income may mean breaking the habit of a lifetime, something that is never easy to do.

Clearly, the more capital you have, the more income you will have. You can supplement your income by living off capital, but that will have a time limit. You could also continue to build up your capital, but that is likely to mean working more than you might wish.

Your net worth is all your saleable assets (what you own that could be turned into cash) less your liabilities (what you owe). As such, it is your total available capital.

A typical net worth statement would look like this:

Assets (+)	Dollar value	Totals
House	\$450 000	
Business	\$350 000	
Shares	\$75 000	
Investment property	\$300 000	
		\$1 175 000
Liabilities (−)		
Business debt	\$125 000	
Property mortgage	\$75 000	
		\$200 000
Net worth		\$975 000

There are a number of things to note with this net worth statement:

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- Items like cars, boats and furniture are not included. These things depreciate over time and are, therefore, really value-losers. In any event, it is very unlikely that you would ever want to sell these things as they are needed for lifestyle purposes. An exception to the rule would be cars that are collector's items. Similarly with furniture—antiques which were purchased as investments that you would be happy to sell to help fund lifestyle costs.
- The house is included. Although you are likely to want to keep the house to live in, it should be considered 'in play' because you could decide to downsize it or upgrade it (or maybe even rent). It may be that to live the life you want you are planning to move to another town or location. There is usually so much capital tied up in a house that it has to be considered. It may also be that you decide to use some home equity release (or reverse equity mortgage) product, effectively borrowing against the house to obtain income (see Chapter 10).
- The business is entered at market value, not net asset value. This means that you add on to the value of the business's assets things like goodwill, licenses and so on, so that you enter a true amount—what you would actually get if you sold the business. What you would actually get for the business if you decided to sell it can be very hard to establish, but it does need to be attempted. It is hard to be free while you still have a business to run, thus you need a reasonably accurate idea of how much capital you would free up by selling it. A call to your accountant may be in order here.
- Liabilities should be established as the amount it would cost to repay all loans in full at this time. This will vary depending on whether a loan involves revolving credit (for

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example, an overdraft) or repaying principal. Call your lender to establish the amounts required.

Your net worth is the size of your bank account if you sold everything, repaid all debt and put the balance in the bank. There is a useful way to think of this: if you decided to have a completely new life in another country and sold up everything before you went, how much would you have? This is looking at your life from the point of view that everything is possible (as indeed it is). It is important to ascertain your net worth at this point—you cannot know whether you have enough to be free if you do not know how much you have. You have achieved your Freedom Figure if you have enough capital (net worth) to produce the passive income you need to live the life you want.

If you do not seem at first glance to have enough net worth, do not despair! There are ways and means—variables can be changed, adjusted and readjusted—which might make the life of your dreams possible. Remember that how much capital you have is only one factor (or variable) out of eight. Certainly, it one of the most important (if you had millions in savings and investments you could almost certainly step back from your work and live an easier life). However, even if you have relatively modest capital you should look at the other seven factors to see if there is a way to rearrange your finances for a better life.

The trap of overestimation

There were eight of us around the dinner table, most of us knocking 50, a few having already stepped through that

door. We had spent the last couple of hours eating and in lively conversation. I had mentioned this book, which at the time I was in the early stages of writing, and some of its themes were the centre of the dinner conversation. Those at the table, all bright and successful professionals, were very interested in the idea of lifestyle and a lighter load.

At one stage, James (a natural leader) hushed the conversation and called for a bit of order because he wanted to hear each person's answer to a question. He went around the table asking: 'How much investable capital would you need to start to ease back?' Each guest gave his or her own answer to this question.

The answers varied quite a lot—from \$1.5 million to \$20 million—with the average at around \$5 million. No one had yet reached the amount that he or she had said was needed, so all felt they had to continue to work full time.

I was surprised. This was a group of successful and relatively wealthy people and several of them felt that they had to keep working as hard as ever. In my opinion they were all grossly overestimating the amount of capital that they needed. They were taking no account of the other factors: they were not accounting for the fact that they would not completely retire but would continue to earn some income from their professions; they were not accounting for the fact that at some stage they could start to spend some of their capital; they were overestimating the amount they would need to live on and underestimating the returns they could get from their investment capital.

The amount of investable capital that you have is only one of the eight factors. Several of this group were refusing to eat any of the eggs their chickens were laying, instead insisting

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on hatching them to breed more chickens. This works well for younger people who are wanting to build up their flock (or wealth) of chickens, but there does come a time when you can start to enjoy what you have built up.

The discussion broke up into a bunch of smaller conversations around the table. But the impression I was left with was that people were grossly overestimating the amount they needed by not recognising that other factors beyond simply how much capital you have are involved.

Chapter 9 | Factor two: the lifestyle you want

Lifestyle is one of the main factors you can work with to make sure you will have enough when you stop full-time work. In some ways this chapter title is wrongly worded: ‘the lifestyle you *want*’ should perhaps be ‘the lifestyle you *could reasonably expect*’. The lifestyle we might want can be quite different to the lifestyle that seems reasonable. We might want a life with villas in Tuscany, big boats, long holidays in St Moritz and the Caribbean, a Learjet . . . But very few people can realistically expect these things and this lifestyle (and even fewer end up having them). You probably have a reasonable idea of the lifestyle that will be within your reach—it is unlikely to be the opulent one described above, but nor is it likely to be mean and poor, living in a small hut in the bush. Somewhere between those two extremes will be the lifestyle that you can reasonably expect for the next twenty (or more) summers.

Your job now is to cost this lifestyle. How much money is it going to take on a weekly, monthly or annual basis to fund it? This is a critical part of the exercise, because you can never answer the question ‘Do we have enough?’ if you don’t know what it will cost you to live and do the things you want to do.

FACTOR TWO: THE LIFESTYLE YOU WANT

Your lifestyle is clearly one of the things you can alter if the answer to the question is negative. Costing our lifestyle and adjusting expenditure so that it is within our means is what most of us have done all our lives.

It is likely that the lifestyle you expect will have a fairly close relationship to the lifestyle you have now, that your expenditure will remain about the same as it has been in the years leading up to your decision to work less and play more. Some people have a very clear idea of how much they spend to live, others are less clear about it. You may for years have lived to a budget and stuck to it very closely; you may just have spent as the money came in. Nevertheless, wherever you sit on what is a very wide spectrum of spending patterns, it is going to be critical as you plan the next phase of your life that you know what it will cost to fund your new lifestyle.

The amount you have been living on up until now becomes the baseline or starting point for calculating what it is going to cost to fund your future lifestyle. But remember, it is only a starting point—there will be changes to your lifestyle and therefore changes to your expenditures.

It has been calculated that on average a retired person lives on 70 per cent of the amount that he or she lived on before retirement. Expenditure often changes for people in retirement for a range of reasons: less clothing expenses (good work clothes are no longer required), less travel costs (often helped by the fact that many couples in retirement only have one car), discounts for senior citizens, etc.

However, you are not going into retirement. You need therefore to be very careful about this 70 per cent figure. Applying it to your current expenditure would be dangerous; it is likely to be inaccurate for a range of reasons:

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- You are *not* retiring and your lifestyle is likely to be quite different from a retired person's;
- Because you are likely to continue to work to some degree, transport and clothing costs may not fall;
- The 70 per cent which financial advisers use is an average—there are many unders and overs;
- You may have higher expenditures in the hobby/sports category (I have enough climbing gear in the garage to fully equip at least three simultaneous Everest expeditions); or
- You may be planning to travel a lot.

The 70 per cent rule may be accurate later (your expenditure probably will fall over the years) but it is not necessarily accurate for those just starting to slow down from work. Instead of simply applying an average, blanket percentage reduction to your expenditures, you should do a new budget, trying to factor in all the aspects of the new life you are planning to have, costing each activity as accurately as you can. You will not get this perfectly right, of course (no budget or plan for the future works out exactly), but as time goes on you can revise and refine your figures. More important than getting this plan for expenditures exactly right is having a realistic idea of what your new life is going to cost; only in this way can you decide whether you are going to have enough.

Therefore, do not sweat the small stuff unduly. The purpose of doing this budget at this stage is to see whether you have enough, whether what you have, and the income you can generate, will fund a lifestyle that is sufficiently attractive. This budget will show what things you might have to cut from your planned lifestyle or what things you will be able to add to it. Without doing some kind of expenditure

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budget, you will never be able to answer the question ‘Will we have enough?’ with any confidence.

The table below is an example of how to work through a budget category by category. This exercise forces you to think about how you are going to live and the money that you are going to spend.

Category	Current expenditure p.a.	Future expenditure p.a.	Note
Groceries	\$10 000	\$10 000	Unlikely to change
Car costs	\$6000	\$4000	Sell one car
Overseas travel	\$0	\$6000	One trip each year
Clothing	\$6000	\$4000	Less work clothes needed
Hobbies	\$3000	\$6000	More garden expenditure and travel for fishing and golf
House maintenance	\$3000	\$500	Do more ourselves

If your expenditure budget works out well within the income you are likely to have, you can relax. Go ahead now and have the life that you want. But if there is likely to be a deficit, or if the budget looks very tight, you have two options:

- Cut some things out of your plan—lower your expenditure and therefore your lifestyle. We all have to do this to

some extent or other (no one can have absolutely everything they want). However, there does come a point where you have to cut out so much that the whole exercise becomes marginal or unworthwhile—you can see yourself living in that little hut in the bush. If this is the case you have a second option.

- Look at the other seven factors (or variables) and see which of them you could adjust to make the plan work. For example, you might decide to work an extra month a year, or to downsize the house to give you more investment capital (and therefore more income). This is the trade-off process which, again, everybody has to do to some extent or other, whether they realise it or not.

I cannot stress enough that looking at your likely future expenditure levels is not about living a poor, mean, miserable little life. You are going through this process at this stage so you can make a plan that will give you the confidence that you will have enough. You want to go into your new life in security—knowing how much this life will cost is a key part of the plan.

Chapter 10 | Factor three: the house you want

The house you want is really part of expenditure for the lifestyle you want, but it deserves its own separate chapter because a house is such a big part of most people's finances. In fact, most people have the bulk of their wealth tied up in their houses.

Quite a lot of couples in their twenties and thirties adopt the 'bigger house' financial strategy. This involves buying a house, paying down the mortgage until it has gone (or at least is greatly reduced) and refinancing to buy a bigger house. Over the course of two or three decades the process is repeated several times, meaning that the couple end up with a very big, very valuable house, but usually not much else. The idea is that later in life they will sell the big expensive house and downsize to something smaller and less expensive. The money left over is to be invested and used for retirement.

There is a lot wrong with this strategy from a financial or investment point of view (including no diversification and no exposure to offshore share markets). But the biggest thing wrong with it is that people who have lived in a big expensive house are often very reluctant to downsize simply because

they have hit the magical age of 65 and decided to retire. People who have had years living in a nice house with all the extras are not at all keen on giving up all the space, the garden and the swimming pool!

Even if you did not adopt the 'bigger house' strategy consciously and deliberately when younger, you may well find yourself caught in much the same bind: most of your wealth is tied up in the house. This becomes very apparent when you do a net worth statement (Chapter 9) and find that in the asset column there is a house with a very big number beside it and not a lot else.

The house is often the most valuable chip that you have to play with, and sometimes, to have enough to slow down and work less, it may have to be sold. In any event, in the planning stage where you are asking the question 'Do we have enough?', the house has to be considered. You have to consider all eight factors, and this is one of the biggest. Some of you will have enough without needing to sell the house or do anything else with it, but many will not. Doing something with the house might not at first seem an attractive option, but it might become more attractive than adjusting one of the other factors (living a less expensive lifestyle, perhaps by travelling less than planned). Thinking about how you might access some of the capital in the house might also prove to be more attractive than simply abandoning the whole idea of living the next twenty summers as you wanted! You have to think of the house as being in play.

So, how might you use the house to help you have enough to live the life you want with less time at the office? These are some of the options.

Borrow on the house using some kind of annuity mortgage

Annuity mortgages are very popular in Europe, and are now available in most countries. These products vary considerably, but the basic premise is that they allow you to draw on the equity in your home by borrowing while still living in the home. The interest on the borrowings you make is not usually required to be paid in cash by you, but is added to the total amount owing. When the house is sold or when you move out or die, the total amount you have borrowed (the principal and the interest) is repaid. You can usually borrow to a total of around 50–60 per cent of the house's value. These products are a little like being able to eat your cake while having it too. They are very suitable for older people but less so for people in their forties, fifties and sixties because the longer time period they are running for means more interest, and so you can draw less for living. Another thing you have to realise is that if you nibble away at the house's equity as you continue to live in it, there will be less inheritance for the children when you die (see Chapter 11).

Sell the house and buy something less expensive

This is the obvious one—but you have to be able to overcome the pain of selling a house that perhaps you like very much and are used to. The idea itself is simple: you buy something cheaper and the capital that you have freed up is invested for income. The negative, of course, is that you no longer own what may well have been a lovely house with all the features and facilities you were so fond of. But the cheaper house may

be no less attractive: the reduction in price comes from its location. Many people in the last few years have sold their house in a major city and moved out to a nearby country area. Others have sold up and moved to a small town on the coast or in the mountains (although these are becoming quite expensive). Because you are unlikely to be working full time, living an hour or so out of a city is much less of a problem than when you need to go into the office every day. Furthermore, a new life often involves working different hours, so that the drive into the city may not be at peak traffic times. If living outside the city is not your idea of bliss, apartment living may be an option—apartments are often significantly cheaper than houses on large sites.

Find a way to derive income from the house

It may be that you can take in a boarder, or convert part of the house into a self-contained flat which can be rented. It may be that you have grown-up children who have descended on you (again!) and could quite reasonably be asked for board. Most people I know who travel for extended periods let their houses, coming back to several thousand dollars of accumulated rent.

Subdivide

Quite a lot of people with houses on large blocks of land are able to subdivide the land. While this can free up quite a lot of capital, it may be unattractive because you will now have a

new house very close by. It may be more palatable to subdivide and build on the subdivision yourself, thus having control over the new building. You can then either sell the new house (hopefully making a good profit) or keep it and rent it out (thereby retaining some control over the neighbours).

Reduce housing costs

There may be cost reductions that you can make concerning the house. Working less ought to mean that you can do a lot more around the house yourself—you may no longer need a housekeeper or gardener, you can look after the swimming pool and other maintenance yourself.

Clearly, you need to think very hard about what you will do with the house when you start to live your new life—there is usually too much capital tied up in it to ignore. Some people hold on to their very nice house, in spite of the large amount of capital it represents, because they can easily afford to. Others who can only just afford to hold on to it do so because, with its garden and swimming pool, they regard it as not just a place to live but as their hobby (and very attractive to the children and grandchildren as well).

When the answer to the question ‘Do we have enough?’ turns out to be ‘no’, you will have to look very hard at the capital tied up in the house. Trading off the home that you have lived in for so long may well be worth it if it means you are able to do the things and live the life you have always wanted. It can be hard, but ultimately you have to decide what is important to you.

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At the other end of the spectrum, some people sell up and resolve to rent for the rest of their lives. This can work particularly well for those of you who have decided to use a lot of your newfound life travelling or working overseas.

Many of you will have to consider how you might access the capital in your house. The house may seem like an unattractive item to trade, but it may be necessary if you really want to live the life you want.

Chapter 11 | Factor four: inheritances

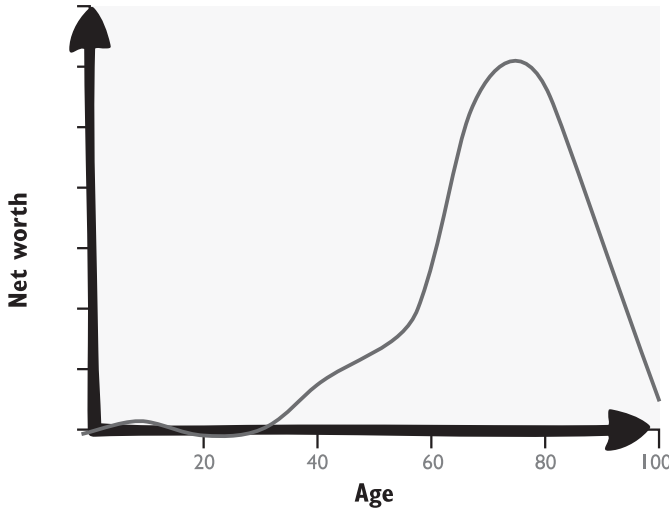
When most people look at whether or not they will ‘have enough’ to last them the rest of their lives, they look only at the income they can derive from their capital. They neglect the fact that they have capital, and that capital can be spent.

If you think back to the discussion of the chicken farmer living on eggs, you will remember that the chickens are the farmer’s capital and the eggs his income. The chicken farmer did not have enough capital (chickens) to provide him with sufficient eggs and resolved this problem by working for a neighbour and being paid in eggs. This is a reasonable solution, but there are others. One of the other options would be to eat a few chickens (which would no doubt make a very nice change from all those eggs). Changing your diet so that you start to eat some chickens does mean that you can eat more, but it also means that you will have less capital and therefore, gradually, a diminishing number of eggs. When living off both capital and income, you are effectively in a race to ensure that your money does not run out before you do.

I have often said at seminars and conferences that you can let the cheque to the undertaker bounce—that is, you can go out on the last dollar. (Some would go further than this and

let the cheques for last week's ski holiday in Switzerland and the wonderful dinner the previous night bounce as well.) Spending capital in this way means that you will not be the richest person in the cemetery. If you want to spend all your capital and can get it right, the graph of your net worth will look like this:

Figure 11.1: Spending all your capital in your lifetime



I have considered the idea that you can take your wealth with you when you die, and I would have to say that the evidence is pretty skinny. You do need to spend it in this world because it is very doubtful that it will be legal tender in the next. However, there are a couple of things which mitigate against spending all of your capital and going out on the last dollar:

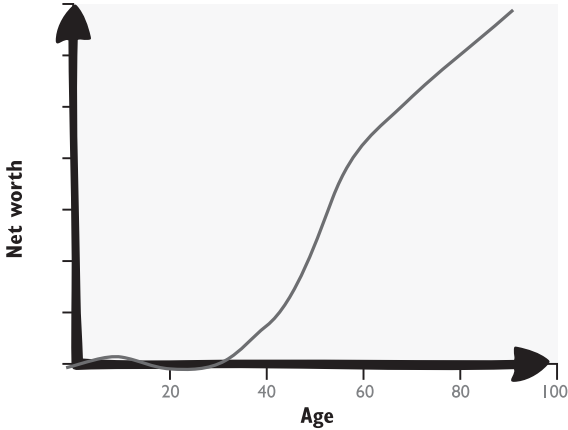
FACTOR FOUR: INHERITANCES

- Most of us want to leave an inheritance to the children. In spite of what some people say about spending their kids' inheritances, I think that most people do want to leave at least something, and often quite a lot. This is probably hard-wired into us—we want to promote our genetic material and an inheritance does help that.
- Most of us don't know when we are going to die and therefore don't know how long we have. If we knew exactly how long we had, it would be a very simple exercise with a financial calculator to work out how much of our money (capital and interest) we could spend on a weekly basis. But most of us do not know, and the fear of the money running out before we do is great. There is a way around this—the purchase of an annuity (see Chapter 10).

Ultimately, how much of your capital you want to spend and how much you want to leave as an inheritance is a philosophical decision, one that we must all make personally (or as families). The amount of capital you are prepared to spend will affect the amount of inheritance you can leave. Conversely, you can establish the amount you want to leave as inheritance and spend the rest. Some people decide to keep their house mortgage free, and this eventually goes as inheritances to the kids, while other assets and investments they spend quite happily.

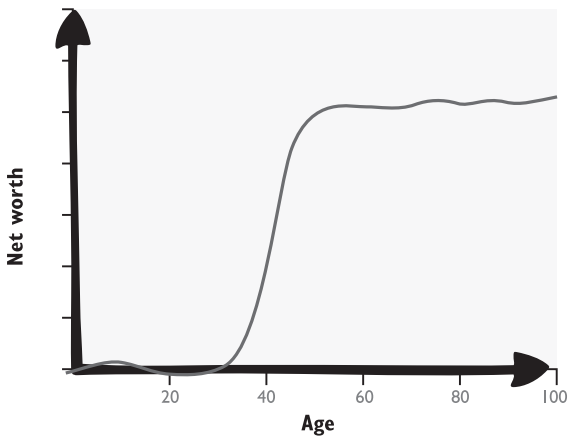
The net worth graph for most people does not show their capital declining very much (certainly not so much that it will go to zero). I do know people who keep growing their net worth so that their graph looks like this:

Figure 11.2: Net worth growth over a lifetime



A lot of people would think that continuing to grow net worth was not very sensible. In which case, the graph for net worth may look something like this:

Figure 11.3: Maintaining peak net worth



FACTOR FOUR: INHERITANCES

One thing to bear in mind when making this philosophical decision: by the time you leave your inheritance to the kids, they are likely to be quite old. If you had children at the age of 30, and you die at the age of 80, your children will be 50 when they receive their inheritances. It is likely by that time that they will be well established professionally and financially (we would hope so anyway!). You could argue that it would be better to spend the money early to give your children the benefit of a good education which will help them throughout their lives.

Whatever you decide about inheritances or use of capital will be an important part of your plan for a new life. It is a factor that you can adjust quite well if you find that the answer to the question ‘Will we have enough?’ is negative. You may decide to spend capital (cautiously, so that it does not run out too soon) to make the financial plan work. For example, if you found that your income from investments and part-time work was going to leave you \$500 per month in deficit, you could decide to start to supplement your income by spending capital.

Receiving an inheritance

While we are thinking about inheritances and the family issues involved, it is useful to mention here that you may well receive one yourself at some point in the future, which will obviously be added to the amount of capital you already have. (Although, some people regard an inheritance as not really being their own money. They consider themselves the custodians of this money, investing it and hoping to pass it on to

their own children and grandchildren and so keep it in the family.)

Dealing with an inheritance can be quite a lot more complicated than dealing with money you have simply saved. The receipt of an inheritance is usually coloured with sadness and sometimes tinged with guilt. It may well be the biggest sum of money you ever receive in your life. With property booms around the globe, inheritances have got bigger as the sale of even quite modest deceased estates can now fetch a large amount of money.

You can never completely rely on receiving an inheritance, however. In trying to answer the question ‘Do we have enough?’, you may be fairly sure that you will receive an inheritance, you may even have a fairly good idea of how much it is likely to be—but you cannot be certain. Therefore, in answering the question, I would suggest that you do not factor in the receipt of an inheritance unless there is some unusual circumstance which makes it virtually guaranteed. It seems to me that to decide that you are going to have enough to work less and live more because you think you might receive an inheritance is a recipe for trouble.

So, what should you do when you receive an inheritance? The simple answer is nothing. At least, nothing for a few months anyway. A time of emotional difficulty is not the best time to make investment decisions, particularly when it concerns perhaps the biggest amount of money you have managed. Put the inheritance away in a bank term deposit for a few months while you think about what to do with it.

Ultimately, the money is likely to be added to your other investment funds. Some people will hold inheritance money as custodians for future generations, but most will use it for

FACTOR FOUR: INHERITANCES

their own purposes. When an inheritance arrives you can add the amount to your net worth—it may make all the difference to having enough to live the life you want.

12 | Factor five: how much will you work?

At the age of 52, I am still not sure what I am going to do when I grow up. At present I am well into my fourth fairly distinct career, and guess that I have at least one or two careers to come. I never intend to give up work (although I recognise that at some point in the future this might change). If I keep doing some kind of paid work for another twenty years or so, you can see that I still have a bit of time to work out what I am going to do when I finally grow up.

Few people want to simply set up a chair in the shade (or by the heater) and spend their days sitting in it. Similarly, few people want to spend all day every day on the golf course, in the garden, travelling or out fishing. Most of us want some kind of focus to our lives and something to strive and aim for. In fact, for many of us it is critical that we have something to strive for—there is no life if we are not pushing to improve ourselves or other things. If you are in your forties, fifties or sixties, you are much too young to just withdraw from the real world.

Most of the clients I've had for WealthCoaching don't want to retire. They want to work less, they want more time and they want less pressure. But they do not want to buy themselves a rocking chair and sit in for thirty years waiting to

FACTOR FIVE: HOW MUCH WILL YOU WORK?

die. They want to work, sometimes for the money and sometimes to give some structure to their lives and so that they feel useful. (Interestingly, virtually every client that I have ever had has said that when they are financially free, they want to put a lot of their time into charitable or community work.)

Having said this, there are of course some people who do not want to work at all but 'retire' in the traditional sense. These people are going to have to fund their lifestyle to a greater extent from somewhere else (perhaps deciding to leave a smaller inheritance, downsizing the house, working a bit longer so that there is more capital saved, and so on). In answering the question 'Do we have enough?' these people are a bit more likely to get a negative reply. Quite simply, without some income from paid work, there will have to be adjustment of at least one of the other seven factors.

In my experience, for a lot of people the amount they are going to work and earn income is often the last factor to be adjusted. People will look at the other things they have and want (their lifestyle, the amount of investment return they can get from their capital, the size and cost of the house), and work until there is no deficit. In other words, they will work to the extent needed to make up the gap between what they want to spend and what they will receive from investments and other sources.

This sees people doing all sorts of things, from working as consultants to taking on special assignments, driving taxis, filling in while others are on holiday, making and selling furniture, doing odd jobs. The bit of money they get from these activities makes all the difference to their lifestyles.

Others work because they really want to: so that they are out in society, meeting people and making a difference.

Professional people often carry on working part time: lawyers become consultants to their firms, working a day or two a week; engineers take on occasional assignments; accountants keep doing the books for a few pet clients; managers take on locums, stepping in to let the usual manager take extended leave; and people with all sorts of skills become consultants taking on occasional clients.

Of course there are also people who work partly because they want to and partly because they have to. Those who have the choice of working or not are the lucky ones. However, if you have to work to make the pieces of the plan fit, you can take some comfort from knowing that even if you did have the choice, you would probably choose to be in some sort of paid employment.

While most people want to work for many years after they have eased back, you have to be fairly careful when establishing a plan which relies on a certain amount of income. This whole area of work is difficult to plan with any precision because of three things:

- **You could change your mind** It is easy enough to say at 50 that you will always want to keep up with some sort of work, but things might look a bit different when you are 75. The road to hell can be paved with the best of intentions. Your intention might be to work for another 25 years, but things may not seem so much fun later on. You cannot therefore be certain that you will have some income from work for all of that time.
- **The type of work you do is important** Most countries now have laws which mean that you cannot be fired because of your age. Nevertheless, some jobs are better

FACTOR FIVE: HOW MUCH WILL YOU WORK?

suited than others to those who are getting on a bit. If you are an accountant, for example, you can happily carry on adding up figures for as long as you can sit upright (nearly!). If you are a builder, however, you probably don't want to be crawling around on the roof of a two-storey house attaching tiles; you will want to find something else to work at, and that in itself takes a bit of planning as you may have to re-skill or up-skill. Finding another occupation which fits your skills in part at least, and adding new skills and getting some experience is not that hard to organise, provided you give yourself a bit of lead time.

- **You could get ill or be injured** This can derail plans at any age, and that includes those who have decided to ease back a bit. If you are dependent on the money that you are to earn from work, you could find yourself in difficulty if you have not insured against this happening.

These three things taken together mean that you do not really know how long you will be able to work. You can take an educated guess, but that guess is likely to be a lot more accurate in the short term than it will be in the long term. Nevertheless, it is reasonable to assume that you will be able to earn some income from work for a considerable time, and I think your plans should include it. You do need to be aware that bad things can happen which will derail your plans, but that, of course, can happen to anyone at any time. Most of the clients that I have worked with have planned to continue to work indefinitely and have planned to use the income that they receive from it.

Part-time options

There are nearly always options for people who are looking for part-time work. While the work you find may not be exactly what you were doing before, there are usually ways that you can utilise your skills for best reward.

A real estate agent could consider:

- Office work for other real estate agents;
- Sales training;
- Preparing houses for sale;
- Other sales areas.

A manager could consider:

- Consultancy;
- Locum contracts;
- Directorships;
- Mentoring;
- Part ownership of a small business (with director's/consultant's role).

A teacher could consider:

- After-school child care;
- Commission sales;
- Tutoring/coaching;
- Relieving;
- Care for children in holidays;
- Adult education in areas of outside interest/expertise.

A business owner could consider:

- Part ownership;
- Consultancy;
- Locum contracts;

FACTOR FIVE: HOW MUCH WILL YOU WORK?

- Tutoring;
- Staff training;
- Troubleshooting;
- Directorships.

Most people have work skills which cross over into other professions. You may have to think about the skills you have and take some advice, but it is likely that you will find something which you can enjoy and gives you income.

Many people have income from sources other than work, investments or a business. This other income obviously has to be taken into account when you are trying to answer the question ‘Do we have enough?’ Not only do you have to identify what other income you have, but you should also look to maximise those income streams and look for new ones.

The types of things that people have as other income are:

- Superannuation payments;
- Government assistance;
- Payments from family members;
- Renting a room to a boarder;
- Income from a family trust;
- Payments from family trusts and estates;
- Annuities;
- Payments from family businesses;
- Royalty payments.

These items of income can be quite important. In some cases they may be quite large and form a significant part of the

FACTOR SIX: OTHER INCOME

income you are going to have. This list is almost certainly not exhaustive—people have all sorts of circumstances and it never ceases to surprise me what people have as income from quite unusual sources.

One area where I do see potential income amongst clients is from their children. This may sound a bit harsh on first reading, and I really am not advocating sending them out to work solely to keep you in laid-back bliss (although perhaps I should be—maybe there is a use for children after all). The area where I see children being a problem with respect to other income is when they return home at the end of an overseas trip or at the end of a relationship—and stay! This is surprisingly common (children in their twenties and thirties often behave like boomerangs).

Well, of course it is nice to have them but in my experience they simply move back into their old room which, along with the contents of the fridge, they regard as their own property. I think it is very reasonable to ask them for board, or at the very least a contribution to household costs. If the board they pay is anything near market levels the amount can be calculated as 'other income'. The only problem with budgeting in this other income is that it is unlikely to last forever—you can be fairly sure that they will be off overseas again or into another relationship soon enough. I would doubt that when you are in your eighties and your eldest son is in his fifties he will still be living with you. The income from him is unlikely to be dependable. Nevertheless, you could commit yourselves to always having a boarder or two, whether these boarders are your children or other people.

This category of 'other income' is a very individual thing. It could come from a range of sources, and in a few cases

TWENTY GOOD SUMMERS

could be increased with a bit of thought. You do need to consider how secure it is and how long it is likely to last. Nevertheless, as one of the eight factors making up the answer to the question 'Do we have enough?', it does need to be considered and accounted for.

Chapter **14** | Factor seven: your age

Strictly speaking, your age is not really a factor in how much you will need. Entitling this chapter ‘Your age’ is really only a polite way of asking when you think you are going to die. This chapter is really about how long you have left to live—how long your money is going to have to last. The fear we all have is that the money will run out before we do—it seems therefore to be fairly useful, when asking if you will have enough, to think about the length of time your money has to last.

This clearly is a factor which cannot be calculated with any precision at all. It is also a factor which really only concerns those who are going to spend some or all of their capital. If you are intending to keep your capital intact to be passed on to the next generation while you live solely on the investment returns, it is not a factor you need to bother with (although you do need to be aware of the effects of inflation—see Chapter 15). In this case, the only real question is whether you are going to pass on the amount of your capital in real terms or nominal terms. The difference between the two is simply inflation. If you have \$200 000 of savings and you want to pass this on to your children in, say, 30 years, when

you die, the spending power of that \$200 000 will be much less than it is today. Even our current relatively low inflation rate whittles away at the value of our capital and our income if we do not regularly increase that capital by 2–3 per cent p.a.

However, even those who want to pass on their capital intact to the next generation need to think about living off their capital (or more accurately, living off their capital gains). This is because you will want to invest in things other than just bank deposits and bonds. You will want to invest in growth assets like shares and property, because over long periods of time these give better total returns, in that they give income, income growth and capital gains. You need to be able to live off the income from your investments, but you will probably have to draw on the capital gain as well. If you do not draw on the capital, you will probably continue to get richer, which in many cases is not what you want. You have probably spent the last thirty years or so building up your wealth and savings, but now that you are going to ease back there seems little point continuing to do so. You will want to be able to draw on the total return from your investments, which means accessing the capital growth that you have.

If, on the other hand, you are going to use some of the capital to live on, you do need to think about how long it will last. As noted previously, you are unlikely to be able to do this with any degree of accuracy—few of us know when we are going to die. In my experience, people considering this factor very wisely behave conservatively—that is, they add a few more years to the number of years over which they are planning to use their capital. The perfect financial plan may be to see the cheque to the undertaker bounce, but in practice this is not as easy as it sounds. Clearly it is better to over-estimate the

FACTOR SEVEN: YOUR AGE

amount of time you need your capital to last than to underestimate it and find yourself living the last few years in penury.

Estimating the number of years you are likely to live is part science, part guesswork. Some of the things to consider are:

- **Life expectancy figures** Remember that life expectancy rises as people get older, so that a 30-year-old might have a life expectancy of 78 years, but the same person at 65 could have a life expectancy of 85 years. Remember also that life expectancy figures are very broad, giving averages across total populations. The variance between individuals is huge.
- **Family history** Longevity runs in some families, and although this is no guarantee that you will not be run over by a bus tomorrow, it does give some pointers.
- **General health and fitness** This is perhaps fairly subjective, but in many cases may be the biggest factor, whether on the upside or on the downside.

You can look at these things quite carefully, but you are still going to have to make a guess. I have thought that I might make 90 (I have a fairly good family history in this regard and keep myself fairly fit) but if I was going to spend capital I would plan for longer than that. Nevertheless, the worst could happen at any time—I could have a major health problem tomorrow or fall off a mountain next week (although my most likely early death would be caused by Joan carrying out her threat to kill me if I leave the toilet seat up one more time).

The practicalities of living off capital can be problematic. Not only do you not know how long it will need to last, but

you also have to have your investments arranged to be able to draw capital as you need it. This of course is no problem if your investments are bank deposits—you can draw on your savings at will. But many of us are expecting to be living off capital for a long period, and having all our savings in bank deposits is not the best way to invest. The length of time you will be investing for (almost certainly decades) means that you really should have most of your money in growth assets like shares and property. If you are going to be investing for twenty or thirty summers (or even longer) you do need to be in better performing, albeit more risky and volatile assets like shares and property.

Your age and therefore how long your money is likely to have to last is the most difficult and unknowable of all the eight factors. It is also one of the most important—get the answer seriously wrong and your money could run out before you do, or you could have a significantly poorer lifestyle than that you were hoping for. It can have a big influence on the answer to the question ‘How much will we need?’, particularly when you are considering whether or not you will spend capital.

Chapter 15 | Factor eight: the returns you will get

Conventional wisdom says that on retirement you should sell your growth assets (property and shares) and invest in things like bank deposits, company debentures and bonds. These things are deemed to be the safest of investments and give the income that you need—both of which are true.

However, what is also true is that you are not ‘retiring’ in the conventional sense. You are easing back to enjoy twenty good summers and possibly quite a few more than that. You need to be able to use your capital for income for some decades, a long time-frame in investment terms. The problem you face is that even our current reasonably benign rate of inflation will, over those decades, erode your spending power. Furthermore, you probably need higher returns than those offered by bank deposits, company debentures and bonds, and given the time-frame you can afford to seek them.

I think that conventional wisdom should therefore be discarded. True enough, you do need to invest reasonably securely, and you do want income, but debt-type investments (bank deposits, debentures and bonds) are not the only options. In fact, I think that a significant proportion of your investment portfolio should be in ownership assets that will

grow—in other words, shares and property. This is because although these things may carry more risk (and show more volatility) they do provide both capital growth and income growth. This growth is critical if you are to get good returns and keep the spending power of your capital and income. The secret, then, is to invest some of your money in higher return assets while trying to keep risk as low as possible. You do not do this by answering advertisements in the newspaper and investing in third or fourth rate finance companies which offer, say, 11 or 12 per cent. In fact, you do not do it by going only into debt investments. You do it by diversifying, with a good proportion of what you own remaining in shares and property.

In a nutshell, the returns from top-class debt investments (bank deposits, government bonds, etc.) are likely to be too low, while third and fourth tier finance companies are too risky. That leaves ownership investments—shares and property. These will give the returns that you want, but they will show some volatility, so you have to realise that the possibility of complete failure of any one company is higher.

There are three things you can do to reduce the risks of ownership investments:

- **Diversify** I am not suggesting that all your investment funds should be in ownership investments. You should have some bonds and bank deposits, investments that will necessarily lower your returns, but also smoothe out the volatility, reduce absolute risk and give you some ready money when economic times are tough.
- **Choose quality shares and quality properties** In the case of property, this means reasonably new buildings, well

FACTOR EIGHT: THE RETURNS YOU WILL GET

leased for a long period, and in good locations. In the case of company shares it means companies with good, safe cashflows. Utility companies and those with very strong brands with high barriers to entry fit this category.

- **Have no** (or, at least, very little) **debt**.

In trying to calculate how much you will need, the returns you are likely to get can be one of the hardest things to decide. This is partly because you have to look at how much risk you can take, but it is also because you are likely to be relying, to some extent at least, on your investments for a long period of time. Over those years and decades there are likely to be many ups and downs, economic boom times, economic stagnation and economic meltdowns. You are in the position of not wanting a major loss that will force you back to work full time.

If you are risk-averse, you should go more into good quality debt investments. This will lower your returns, but if it lets you sleep better so be it. The benchmark of investment returns of 8–10 per cent is for people who are prepared to tolerate some volatility. If you cannot accept some volatility, accept lower returns. Furthermore, do take some advice from a professional adviser—someone who will assess your risk profile and will suggest investment options that suit your particular circumstances.

At the time of writing we have enjoyed a period of economic growth which perhaps seems very good for investors. So it is for those who already own investment portfolios—both their shares and properties have done very well. But these are not good times for people who have cash and are looking for good investments which offer high returns. This is because interest rates are low and both shares and property

are at high levels; dividend yields and property yields are therefore very low. People trying to invest at the moment, especially those who are looking for income from dividends and rents, find it hard to get a decent return (hence all of the third and fourth tier finance companies offering high interest returns to the gullible).

My benchmark for returns from Security Assets is that you should be able to get a return of 8–10 per cent before tax. I acknowledge that this is hard at the moment (although by no means impossible). It is hard simply because interest rates are low and share and property values are high, meaning that cash yields are low. This will not last forever—there will be times when interest rates and property and share yields are more attractive. You may have to be patient! Nevertheless, depending on a range of factors (including your appetite for risk, the duration that you choose to invest for, your investment skill, and whether you invest directly or through managed funds), you should be able to get an invest return of somewhere in a range of 8–10 per cent before tax on your Security Assets.

Inflation

You also need to think about that old bogey, inflation. The yield you are getting on your investments might be enough to live on in today's dollar terms, but even a low inflation rate of, say, 2 per cent will erode the value of your investment over time. You need to think about this; an 8–10 per cent yield may give you enough at the moment, but if it does not grow it will not be enough later (unless you can tolerate a lower standard of living). You also need to watch out for inflation

because if it gets away again as it did in the 1970s and 1980s you could be in serious trouble. Inflation is very bad for those on fixed incomes—that is, those who are only in debt investments where there is no prospect of income growth.

All the calculations you do to work out if you have enough (and the examples in the next chapter) are based on what income you will have in the first year of easing back. In, say, twenty years, you may have the same nominal income but this will not have the same spending power.

There are four things to consider when planning to take account of inflation:

- Remember that your expenditure is likely to fall as you get older. Expenditure will not decrease over the years in a straight line, but it is likely that your expenditure at age 80 will be lower than at age 65.
- Invest at least some of your money in growth investments. It must already be apparent that I believe this is what most people should do. Property and shares should both show capital and income growth over long periods of time.
- Decide that you will make up for the effects of inflation by using a part (or all) of your capital to supplement your income. This will necessarily mean smaller inheritances to the kids.
- Reinvest. Even if your investment portfolio is going to yield 10 per cent p.a., plan in the early years to spend only a part of this income so that your wealth is growing a little at the beginning. Over time you slowly start to spend more and more of your income. For example, if you are getting 10 per cent p.a. on your investments, plan to only use 8 per cent in the early years, reinvesting a little for the future.

Incorporating inflation into your calculations is very difficult because of two factors:

- We do not know what the rate of inflation is likely to be over the next twenty or thirty years. We can hope that it will be around 2 per cent, but it could be more, it could be less. (It may be that we even have a period of deflation, which would pose a whole new set of problems.)
- We do not know how long we are going to live. We can take an educated guess at it (and allow a few more years to ensure we come out on the right side of the equation) but it is possible that inflation could eat away at your capital and income for forty years or more.

Although you may never be able to calculate the precise effects of inflation on your capital and income, you need to allow for it in your long-term planning. In my view, this means being fairly careful and cautious, making sure when you answer the question ‘Will we have enough?’ that your income does more than simply match your expenditure for the next year. A tight budget like that will inevitably lead to problems in the future—problems which will mean that although you could answer, ‘yes, we will have enough’ in one year, you could in a few years’ time be saying, ‘no, now we don’t have enough’. Be conservative in your plans and make sure that you have a good part of your investment portfolio in growth assets.

In summary, to plan how you are going to live when you are earning less from work, you need to think about the returns that you will get from your investment capital. With a diversified portfolio, my benchmark of 8–10 per cent before

FACTOR EIGHT: THE RETURNS YOU WILL GET

tax is quite possible over a lengthy period, but there will be some ups and downs. A return of this magnitude before tax translates to perhaps 5–6 per cent after tax. If you are particularly risk-averse you may aim for a somewhat lower return than this, using investments like bank deposits and government bonds.

Chapter 16 | So, do you have enough?

To answer the question posed by this chapter title, you will have to go through each of the eight factors discussed in chapters 8 to 15, giving an answer to each one. These factors are:

- The amount of capital you have;
- The lifestyle you want;
- The house you want;
- Inheritances;
- How much you will work;
- Other income;
- Your age;
- The returns you will get.

Unfortunately, you cannot do this entirely by numbers. Answering this question is part science, part art. There is a good bit of judgment involved, as well as prediction of the future. However, below is a template which asks the right questions and lets you fill in some numbers to see if you will have enough. The process is not meant to be exact but is enough to give you a reasonable indication. It is what I use in WealthCoaching to calculate the Freedom Figure for clients.

SO, DO YOU HAVE ENOUGH?

The calculation process is iterative. You have to look at each item, seeing if you can live happily on what you have. If the answer is 'no', you have to adjust and re-do the plan, and keep on re-doing it until you are satisfied you have enough. If the answer continues to be 'no', then you probably don't have enough yet and had better keep working and growing your wealth. Even if the final answer is 'no', the process will at least allow you to see what your Freedom Figure is, and thus give you a goal to work towards.

Freedom Figure Calculation

Step 1

Calculate your net worth (see page 59). Include your house in this exercise.

Step 2

Deduct the value of the house you want to live in when you have eased back. This may be of less value than the one you now live in if you are planning to downsize.

Step 3

Deduct the value of any major lifestyle assets that you plan to buy (holiday house, boat, etc.).

Step 4

Having deducted steps 2 and 3 from Step 1, you now have the amount of capital available to invest.

Step 5

Apply the before-tax return you are likely to get from your investments. Allow for inflation, especially if investing mainly in debt investments.

Step 6

Add any income you expect to receive from ongoing work.

Step 7

Add any other income you are likely to receive (e.g. superannuation, annuities, taking in a boarder).

Step 8

This is your total income before tax.
Now deduct tax to get an after-tax figure.

Step 9

Do an expenditure budget and enter the figure for living costs here.

Step 10

Deduct Step 9 from Step 8. This is your surplus or deficit.

If you have a surplus

Congratulations! You have enough to ease back and enjoy a lot of really good summers.

If you have a deficit

Don't give up yet! You need to go back to the beginning and run through the assumptions you have made, and do the numbers again. If the deficit is not too great, you may still have options. Ask yourself:

- Are you sure that your net worth statement is correct?
- Can you downsize the house?

SO, DO YOU HAVE ENOUGH?

- Do you really need those lifestyle assets (boat, etc.)?
- Can you get higher returns?
- Are you prepared to live off capital to some extent?
- Can you cut the expenditure for your lifestyle?
- Are you sure that you can have no other income?

If you still have a deficit

You are probably going to have to work longer and continue to build up your capital. Work through the process again to see how much capital would make things work and allow you to ease back.

If you still don't have enough:

- Work out how much you will need (your Freedom Figure).
- Put a time to when you will achieve this.
- Write down your Freedom Figure and the time by which you will achieve it—this is your big financial goal.
- Plan to use the time that you have to retrain so that you can continue to work part time.

It may be that you come back again to this process when you have finished this book.

Example 1

Tom and Jenny are ready to semi-retire. They are both teachers, living in a large city, but are planning to move to a smaller town to be nearer their children (and impending grandchild).

Freedom Figure Calculation

Step 1

Calculate your net worth (see page 59). Include your house in this exercise.

Tom and Jenny have a net worth of \$950 000. They have a house worth \$700 000 and investments of \$250 000.

Step 2

Deduct the value of the house you want to live in when you have eased back. This may be of less value than the one you now live in if you are planning to downsize.

Tom and Jenny are moving to the country and so would downsize the house to one worth \$500 000.

Step 3

Deduct the value of any major lifestyle assets that you plan to buy (holiday house, boat, etc.).

Tom and Jenny plan to do a lot of travelling in a motor home and have budgeted \$50 000 to buy this and a boat.

Step 4

Having deducted steps 2 and 3 from Step 1, you now have the amount of capital available to invest.

\$400 000 to invest (total net worth of \$950 000 less \$500 000 for the house and less \$50 000 for the motor home and boat).

Step 5

Apply the before-tax return you are likely to get from your investments. Allow for inflation if investing mainly in debt investments.

Tom and Jenny aim to achieve a return of 8 per cent before tax (\$400 000 @ 8% = \$32 000).

Step 6

Add any income you expect to receive from ongoing work.

Tom and Jenny are both going to coach maths and reading and expect to earn a total of \$20 000 p.a. between them.

Step 7

Add any other income you are likely to receive

(e.g. superannuation, annuities, taking in a boarder).

None

Step 8

This is your total income before tax.

Investment income: \$32 000

Coaching income: \$20 000

Now deduct tax to get an after-tax figure.

After-tax income: \$40 000

Step 9

Do an expenditure budget and enter the figure for living costs here.

Living costs: \$35 000

Step 10

Deduct Step 9 from Step 8. This is your surplus or deficit.

Surplus: \$5000

Tom and Jenny can start to plan for their new life with some confidence. There is not a great surplus but enough (and they know that if they have to they can go back teaching,

unattractive though that idea may be). The \$5000 surplus can be reinvested for a few years, which will help cover them for inflation.

Example 2

Clint owns an auto-electrical business. The business has three staff (the management of whom provides a constant headache for Clint). He is sick of his business and at 51 wants to travel (something he missed out on when he was younger).

Freedom Figure Calculation

Step 1

Calculate your net worth (see page 59). Include your house in this exercise.

Clint has a net worth of \$740 000 (his house at \$500 000 and the business worth \$240 000).

Step 2

Deduct the value of the house you want to live in when you have eased back. This may be of less value than the one you now live in if you are planning to downsize.

Clint wants to continue to live in his house.

Step 3

Deduct the value of any major lifestyle assets that you plan to buy (holiday house, boat, etc.).

None

Step 4

Having deducted steps 2 and 3 from Step 1, you now have the amount of capital available to invest.

Clint will have \$240 000 to invest provided that he can sell the business.

Step 5

Apply the before-tax return you are likely to get from your investments. Allow for inflation if investing mainly in debt investments.

Clint knows nothing about investment but a financial adviser tells him that he should get 8 per cent before tax.

Step 6

Add any income you expect to receive from ongoing work.

Clint has an opportunity to teach his trade at the local technical college and should earn around \$10 000 p.a.

Step 7

Add any other income you are likely to receive (e.g. superannuation, annuities, taking in a boarder).

None

Step 8

This is your total income before tax.

Investment income: \$19 200 (\$240 000 @ 8% = \$19 200)

Teaching income: \$10 000

Total before-tax income: \$29 200

Now deduct tax to get an after-tax figure.

After-tax income: \$25 000

Step 9

Do an expenditure budget and enter the figure for living costs here.

Living costs: \$37 000

Step 10

Deduct Step 9 from Step 8. This is your surplus or deficit.

Deficit: \$12 000

Clint is not in a position to sell up and go to a new life yet.
He needs to:

- Check to make sure that the business is really worth \$240 000 (maybe it is worth more).
- Decide if he really wants to keep the house. Perhaps he could downsize?
- Perhaps look for higher investment returns (although they would have to be very high to close the deficit).
- Consider his budget. Perhaps he can live on less?
- Work more at teaching, perhaps?

Clint is not likely to be able to make the break at this time unless he does something radical like downsizing the house or making a dramatic cut in his budgeted expenditure. Clint needs \$12 000 more income p.a. and to get that will need \$200 000 more capital invested at 8 per cent before tax to bridge the gap. Even then, Clint will have no buffer if things go wrong, nor would he be allowing for inflation.

SO, DO YOU HAVE ENOUGH?

My advice to Clint will be to set a goal to achieve an additional net worth of \$250 000 in the next three years. He can do this by running the business hard, developing it to make it more saleable at a better price and by taking out profits and saving them. Clint should also be starting to do some tutoring, developing a network at the college so he can get more work than he has been offered. If Clint does these things and does them well, he has a good chance of being able to get out of the business. If he doesn't, he could be stuck there, unable to get out until he is able to draw on his superannuation.

Section | 3

Making it work

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Chapter **17** | Arrange (and maximise) your investments

When you start to ease back and earn less, your investment strategy will have to change, from a strategy designed to build up your wealth to one where you start to live off your wealth. This means moving from having predominantly Wealth-Creating Assets to Security Assets. This change does not necessarily have to happen suddenly—it may be gradual and progressive over several years. (It may take some years simply because you want to pick a good time to sell out of some investments and a good time to buy into others.) You should aim for an investment return from your Security Assets of 8–10 per cent before tax. This is significantly lower than what a lot of people aim for when they are younger and are engaged in building up their wealth. Nevertheless, a return of this amount before tax is still quite a high rate of return—not something you will get by simply putting your money into bank deposits or government bonds.

Your investment needs will have changed. Specifically, you will have to do two things:

1. Use your investments for income on which to live.
2. Lower the amount of risk you take.

There is one big issue that makes the difference between Wealth-Creating Assets and Security Assets—something that both lowers risk and gives you more income. That is the amount of debt you have. Borrowing to own investments is critical if you are to build up your wealth quickly, and as such is the key to Wealth-Creating Assets. Borrowing to buy investments (called gearing or leverage) turns an ordinary investment performance into a stellar investment performance. Gearing up investments also converts income into capital growth. The cost of borrowing (interest) has to be met, usually out of the rents or dividends from the investment. This means that when you are borrowing to own investments the income you get from them is reduced. However, because you are borrowing to own an investment, you can buy more of an appreciating investment and so capital growth will be greater. Gearing therefore means that your income is less, but your capital gains are greater.

Gearing works very well when you are trying to build up your wealth. You do not really want income (hopefully you are getting plenty of that from your work or your business). However, when you start to earn less from your job or business and begin to live off your investments, the income you get from your investments is critical, the capital growth less so. Gearing works brilliantly for younger people, but when you start to live off the wealth that you have created it is time to look for more income with less risk. This precludes gearing.

The obvious outcome is that you should have much less debt (or preferably no debt) when you ease back. Not only do you want more income and less capital growth, you also need less risk. Gearing works very well when assets are

appreciating but it is a disaster when they fall in value. You can gear up your investments but you can also gear them down as well.

Therefore, when you choose to earn less you should sell some of your investments and repay debt. It will mean that you sell some of your investment properties, repaying the mortgages you have on them, and use the equity to retire other mortgages. It will mean selling off investments to repay the house mortgage. It will mean cashing up any shares or investment warrants which have borrowings on them. Again, this does not have to be done in a hurry—you do not have to do it the day you leave your job. There could be significant financial disadvantages to doing this in a hurry—for example, if you have a fixed rate mortgage, you will want to wait until the fixed period has expired. If the market is in a down period, you would not sell into the gloom just because that is the day you are leaving your job and moving to the country. You do want to get yourself into a position of being debt free, but it does not have to be immediate.

The difference between a Wealth-Creating Asset and a Security Asset is often gearing (or debt). For example, a property with 80 per cent of its value borrowed is certainly a Wealth-Creating Asset, quite risky but likely to show very high returns over time; the same property with no debt is a Security Asset, quite safe and giving good income with some moderate growth as well. It can also be about the degree to which you have diversified—a share portfolio with only four or five elements means that the investor is taking a big position; a share portfolio spread across many industries and several different countries will perhaps show lower returns but will definitely be less volatile.

The transition to Security Assets should not be difficult, even though it may take some time to complete. You have to get yourself into a position where you are well diversified with quality income-producing assets with no or little borrowings. This will probably mean that you have to sell some of the investments you currently own to retire debt and invest in other, safer investments. The things that you sell will be things like your business if you have one, highly geared property and some shares (particularly if you have a lot of just one company).

The investments suitable as Security Assets are:

- Diversified shares;
- Property with no or low borrowings;
- Bank deposits;
- Cash management trusts;
- Good-quality bonds;
- Managed funds based on any of the above;
- Good-quality finance company deposits;
- Good-quality debenture stock;
- Capital-guaranteed hedge funds; and
- Diversified managed funds.

These are the sorts of things you should be aiming to transfer your wealth into. They are not very exciting, but then excitement is not really the point. You want your money working quietly away for you, producing returns without too much worry. While you may prefer to be quite active in the management of your investments, you do not want everything hanging on the performance of a particular market or investment. That means setting things up so that you can get on and enjoy your next summers.

The transition

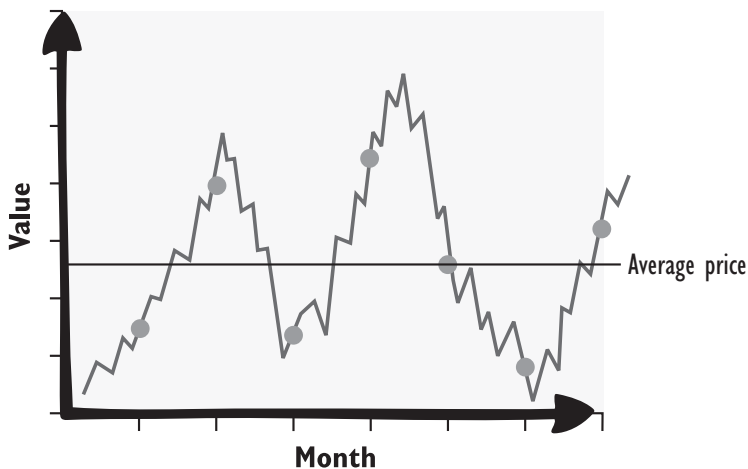
I have already said that you do not need to make the transition from Wealth-Creating Assets to Security Assets in a big hurry. In fact, there is every reason why you should not do so. Just because 25 October is the day you resign your job and start to work as a consultant, or the day you sell your business, does not make it the perfect day for either selling investments or buying them. This is really about trying to time the market, something which, while difficult, is not impossible to do. The small ups and downs of markets are very difficult to predict, but the bigger movements are easier. It is possible to look at the returns you might get from a particular investment market and judge that they are not high enough to make an investment (because that market has already had a major run-up), and therefore choose not to invest until the market has come back to a more realistic level. This could take several years to happen; in the meantime you just hold cash and wait. Holding cash may seem frustrating, but it seems to me better to do this than to invest at a time which is really not good. Conversely, you may judge that a particular time is not good to sell into, and have to wait until the market improves before cashing up.

Patience is a great virtue in this respect. Because you are playing with your life savings, you are much better off missing an opportunity than being stampeded into doing something hasty. There is an old investment saying: 'Buy in gloom, sell in boom'. It is much harder to do it than it is to write it, but following this advice, taking a contrary view to the rest of the market, is very rewarding.

Some people are not concerned with trying to time the

market. They follow a strategy called ‘dollar cost averaging’. Dollar cost averaging means that you buy into a market over a period of time (often some years). Its basic premise is that you are not trying to pick good times to buy, but instead drip-feed money into the market on a regular basis (monthly or quarterly) and so get an average price over that period. Dollar cost averaging also works very well when selling. Although some asset types are not good subjects for this approach (for example, your business or a property investment), others (particularly shares) are very good for it. You decide that you are going to transition out of certain shares to go into others (perhaps from growth shares to high dividend shares). If you didn’t have a view on whether or not it was a good time to sell, you could sell portions of your shares at regular intervals, and so get an average price for them over that period.

Figure 17.1: Dollar cost averaging in shares



I think dollar cost averaging is a very good idea for those who are making the transition from Wealth-Creating Assets to Security Assets. It does require patience and it does take some discipline to keep doing it whether the market is up or down. However, dollar cost averaging will save you from getting caught by a large swing (either on the upside or the downside) with a resultant loss. This is your life savings we're talking about—a major mistake could see you back at work (or back into business) with all your dreams of a better life gone. This is a time to invest cautiously and conservatively, and have a lot of patience. You are better to put the transition to a new life off for a year or two rather than attempt to rearrange your affairs immediately.

The big wait

The old investment adage, 'Buy in gloom, sell in boom', is much easier to write about than to put in practice. When markets are booming, everyone wants to be in. But when markets are high, yields are low—that is, the income returns you are likely to get are quite small compared to what you get in more normal times. Investing into a booming market is not only likely to give you lower returns but could also lead to a significant loss.

When you are living off your capital, you are dependent on that capital. This means that you have to be even more careful and conservative with it than in the past. While you do want to get a good return, I think you should always err on the side of caution. That may mean waiting—and waiting some more if that's what's needed.

The thing I find the hardest when markets are booming is stopping people going into them. Many, many times I have had clients who have been cashed up (perhaps because they have sold their business, received an inheritance, got a severance payment or downsized the house) and been looking for good investments. When markets are high there may not be much in the way of good investments, but these people are impatient. They know they can do better than having their money in the bank and they want to do better now!

Well, it is true that over a long period you can do better than having your money in the bank. But there are times when markets are so highly valued that you are better off with your money in the bank, getting a paltry 6 per cent or so, but at least keeping your money intact so that it is available for investment when markets return to a better level. When dividend yields and property yields are at 1 or 2 per cent you are better to wait than to be sucked into the crowd.

It may seem like a long wait. However, these are your life savings—if in doubt, stay out.

Chapter **18** | Build a portfolio

Investment is all about balancing risk and return. As someone dependent on the income from capital (and needing to protect that capital), you need to set the amount of risk that you are prepared to tolerate. You cannot completely eliminate investment risk—even governments have been known to renege on their bonds at times—but you can significantly reduce it. At the same time you probably cannot afford to accept very low returns, say, the interest on bank deposits. While these are very low risk they will not provide sufficient returns for most people to live decently. You need therefore to find a balance between risk and return—a balance that is right for you.

Aiming to achieve an investment return of 8–10 per cent before tax will almost certainly mean having some ownership investments. If you are not prepared to keep on or take on some ownership investments, you will almost certainly have to lower the return target you were aiming for. Accepting lower returns by weighting your portfolio towards good quality debt investments, is a very reasonable thing to do if you cannot tolerate the greater risk that comes with ownership assets.

model a particular portfolio and say that this group of investments is likely to show losses in one year in every five, while another group is likely to show negative returns one year in every nine. Given that you are investing over a few decades, you need to remember that there will be some difficult years during that period. You need to think about the level of ups and downs that you can live with, remembering that the higher the returns you seek, the more volatility you will have to withstand.

Debt investments (bank deposits, bonds, etc.) are likely to show less volatility than ownership investments (shares and property). Moreover, debt investments are less likely (all else being equal) to show absolute losses—that is, they are less likely to crash and burn. In the case of a company's liquidation, the people who have lent the company money have priority in repayment over the people who own the company. Volatility is one thing, complete investment failure is another! Although when all else is equal there is a greater chance of complete failure from ownership investments than debt investments, all else is seldom equal. There is certainly a greater chance of the complete failure of a third or fourth tier finance company, taking down both its debt investors and its ownership investors, than there is of the complete failure of a solid industrial or utility company.

Debt investments have an important place in building a portfolio. Their place is to give you cash which will always be there regardless of the state of the markets. Holding cash means that during one of the downtimes you will periodically face, you will not have to sell shares or property. Being a forced seller into a bad market is one of the biggest causes of investment loss. Holding some bank deposits means you can

use these to live if you need to, while you ride out the negative times of a volatile market. This is a very good way of dealing with market volatility.

The key to worry-free investment is diversification. To build wealth you want just one asset (a business, shares or property), which you drive hard to make yourself as wealthy as possible. As you become dependent on your savings, you want many more investment types giving strength and security to what you own. Note that it does not matter how much investment capital you have—diversification is still the key. Whether you have \$50 000 or \$5 million to invest, the rules are the same. Someone with a lot of money may be able to carry a bit more risk, but they will still want to avoid having all their money in just one or two investments. As we get older, none of us want to take risks that we could not recover from. The way to cut risk is to retire debt and to diversify.

You can (and should) diversify in all sorts of ways:

- By asset type (shares, property and deposits);
- By having investments onshore and offshore;
- By having your investments spread around several industries;
- By having different managers (some directly managed by yourself, but using a spread of different fund managers).

Diversification is just so important at this time of life—never forget that you are dealing with your life savings, that one major calamity in an undiversified portfolio could mean you have no good summers. When clients have large amounts of cash (perhaps because they have sold their business or a property), I even suggest that they don't have all their cash

with just one bank (even banks have been known to go broke). I certainly would never like to see all of a client's managed funds with one fund manager, and am also uncomfortable when a client has all his or her wealth in investment property. There are plenty of examples of people who have stopped work to live well who have lost everything, sometimes through a company going broke, sometimes through fraud. The way to stop this happening to you is to arrange things to ensure that you could stand to lose any one investment without damaging your lifestyle too much.

Diversification will mean that your returns are lower. However, this is a time of life where investment returns are less important than the ultimate return of your capital. Having to manage and keep records for many different investments may also be something of a time-consuming bore, but that is the price for safety. Better for it to be a bit of a bore than to take an unsustainable loss.

A lot of people find the investment world very confusing—there seem to be so many investment types and options available. Anyone can be forgiven for feeling confused and wary of all the claims and counter-claims from the many different institutions promoting their own investment products. But when you really boil things down, there are only three types of investment you can make:

1. Shares;
2. Property;
3. Interest-bearing deposits.

Everything else is either speculation (such as gold, art, antiques, commodities) or a means through which you can

invest (for example, unit trusts, syndicates, managed funds of all types). This last group is a vehicle in which you can invest. They work by investors pooling their money, appointing a manager and letting that manager invest in one of the three investment types (or indeed, in all of the investment types).

Of the three investment types (often called asset classes), the first two (shares and property) are *ownership* investments (because you own the investment) while the other (interest-bearing deposits) is a *debt* investment. Ownership and debt investments have different characteristics and are discussed on page 130 onwards.

Before building a portfolio of Security Assets, there are three questions you must answer.

How much of the portfolio will you manage yourself?

Your choice here is between investing via managed funds (unit trusts, investment trusts, syndicates, etc.) and investing directly yourself into shares, property and interest-earning deposits. For example, you could purchase a rental property or two yourself, or you could invest via a real estate investment trust; you could select and purchase individual shares to build up a portfolio, or invest via a share unit trust. The choice is between doing it yourself, or paying someone else to make investment choices for you. When you have started to ease back, you will have more time than you used to have—you might get a lot of satisfaction from using that time to actively manage your investments, even if you have never invested directly before. You will probably have the time to

learn and gradually start to make more and more investment decisions yourself.

The good thing about managed funds is that you have a professional managing your investments for you—someone who is qualified and skilled at analysing the markets and making investment choices. Moreover, by investing in managed funds you will tend to own better quality investments. This is particularly noticeable in property investment: you may have enough money only to buy one fairly ordinary rental property, but a real estate investment trust has enough capital to buy a wide range of really good buildings. I would rather own a small sliver of a trust or company with top-quality buildings than 100 per cent of a building that was ordinary. Furthermore, I do not want the hassles of management—I have enough to do without looking after tenants. The downside of investing through managed funds is that they cost—and these costs do eat into your returns.

On the whole, I think that a lot of people who have started to live off investment income can do quite a lot of their own investment management. It is a great interest and you will feel more in control. You don't need to have all of your investments made directly, however—indeed, you probably shouldn't. For example, you might have your offshore investment money in managed funds, and possibly your property allocation. I think that I have most of the skills to invest well, but we still have quite a lot of our money in managed funds. Remember also that this is not a decision that you have to make and stick to forever. You may decide to invest mostly through managed funds while you learn about investment, increasing the amount that you invest directly as you gain skill and confidence.

How much will you put offshore?

You need a good part of your money offshore—by no means should it all be onshore. This is not so much that you will get better returns offshore (although you might—there are a lot more opportunities), but rather is about managing risk. The best way to think about this is to imagine some national calamity—say, foot and mouth disease wrecking agriculture, or a virulent SARS-type illness devastating the population. That could wreck the economy for a decade or more, and it would be very comforting to have some money in Europe or the United States.

A further risk is the exchange rate. At times when I go to London I am amazed that I have to save up to pay for a night in a very ordinary hotel. This is largely because of the current strength of sterling. If you are planning to travel quite a bit, you should have offshore investments in a currency like the US dollar, pounds sterling and euros as a natural hedge against the costs of travel within these countries.

Generally, I think that people should have 40–60 per cent of their investment capital offshore.

How much will you have in ownership investments?

Over long periods, while ownership investments do give better returns than debt investments, they are also more volatile and carry more risk of complete failure. As noted previously, conventional wisdom says that on retirement you sell out of ownership investments and invest very conservatively in bank deposits and government bonds. I think that

this is too conservative. You will be a long time dependent on income from your capital and you need the growth that shares and property give. Note that this growth is both income growth and capital growth, neither of which you will receive from interest-bearing deposits. There may be a few very wealthy people who could happily live on the returns from bonds and bank deposits—but not many. Most of us need to keep up with inflation at least, so that the spending power of our investment income is not eroded over time.

This is not to say that there is no place for debt investments in your portfolio—there certainly is. You need some debt investments:

- To give you the ability to cash up quickly for emergencies;
- To tide you over if your other investments have lean (or downright bad) times;
- To give steady, very predictable income;
- To have some investments that will not move in the same direction as the others in your portfolio (called co-relation in investment terms).

It is likely that over time you will change your allocation towards interest-bearing deposits (debt investments). As you get older (into your seventies, eighties and nineties) and the amount of time you have to make your investments work for you becomes less, you may gradually come out of ownership investments and have more in debt investments. Ownership investments are necessary for those who have a longer timeframe (they will give better returns over a decade or so), but you are unlikely to have the ability to withstand much volatility as you get older. This is particularly so if you are

TWENTY GOOD SUMMERS

needing to live off capital to any extent. The last thing that you want is to get yourself into a position where you really need to cash up some shares—that may come just at the wrong time, when the markets are in a down phase.

In your fifties and sixties, your portfolio might look like this:

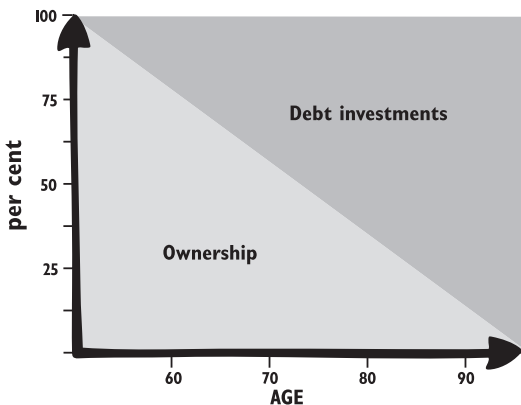
Shares	40%
Property	30%
Deposits/bonds	30%

By the time you get into your eighties, it might look like this:

Shares	20%
Property	10%
Deposits/bonds	70%

By the time you are into your nineties, you may be 100 per cent in deposits.

Figure 18.2: Changes in a typical investment portfolio over time



BUILD A PORTFOLIO

These are not meant to be model portfolios to be followed slavishly—building a portfolio is not about following what someone else has. We all have different positions in terms of:

- Our investment skill;
- How much capital we have;
- What returns we want and need;
- When we will want the return of our capital;
- The time we are prepared to put into managing our investments;
- How much we worry about our money; and
- Whether we need to live off capital.

These factors are a mix which makes the building of an investment portfolio something that is individual to you. Individualisation is the thing that makes managing money interesting—it is finding the right fit between the individual and their portfolio. Individualisation makes it very difficult to generalise in a book like this about the allocation you should make to each asset type. On the whole, however, I think that most people who have started to ease back should have quite a lot in growth assets (shares and property) and relatively little in debt investments—particularly while you are still working to some extent. This allocation may change over time as growth of both income and capital become less important and you can tolerate less risk.

The allocations when you start to ease back are probably in this range:

Shares	10–50%
Property	10–50%
Deposits/bonds	20–50%

If you still own a business (or a part of a business), its value should be considered as part of the allocation to onshore shares. Note that no more than 80 per cent of your portfolio should be in a combination of shares and property (ownership investments) or, to put this around the other way, you should have at least 20 per cent in deposits (debt investments). I acknowledge that this is a very wide range—there is plenty of room for individualisation within these allocations. Further, I cannot stress enough that these are the ranges for when you *start* to ease back—they will change as you get older.

Perhaps more important than anything else is to take *time* and *advice* before you start to build your portfolio. If you are not sure—wait. If the markets seem overvalued—wait. There is nothing the matter with holding cash. Certainly over a long period you can do better than holding cash, but there are times when holding cash is a very useful position to take. Do not get panicked into what seems to be a very good market because that is what everyone else is doing. Do not be despondent and give up because you miss an especially good opportunity—rest assured, there will always be others. All your plans, and the wonderful life that you should have, can be dashed on the rocks of undue haste and greed.

We've all had them: a fax from Nigeria or a phone call from some very enthusiastic broker calling from Manila. Wherever it is from, it is offering some wonderful way to make money—so good that it is too good to be true. And of course that is right: it *is* too good to be true.

However, although we all know there are scamsters and fraudsters out there, and some are probably making a good

living, it is amazing how many people fall for the pitch. Every year we hear of another group who have been fleeced of their life savings.

Frauds and scams have three features:

- They offer very high returns (impossibly high);
- The promoter insists that you have to do it now (there is always a reason for immediacy);
- The minimum amount you can invest keeps reducing (the \$250 000 minimum investment comes down to \$10 000).

Forget these sorts of things. This is truly a case of if it sounds too good to be true, it is.

Chapter 19 | The place of property

Property can be a great Security Asset—provided it is not mortgaged. Borrowing to buy property (gearing or leverage) is a very good way to build up wealth. However, when you have debt on a property, the lender (usually a bank) will want to see its interest continuing to be paid regardless of what is happening to the property. If you lose a tenant and so lose your income when a property is mortgage free, you have some problems. When you lose a tenant and your primary income when you have a mortgage, you have real problems. The biggest of these problems is called a bank, and it is not likely to show very much sympathy. That is why a property is only a Security Asset if it has no (or at least very little) debt.

You have to acknowledge that property investors do from time to time have vacant, income-less properties. Sometimes this may only be for a couple of weeks, however there are times when property, regardless of the type, can sit vacant for months. A younger person is often able to pay the interest by working a bit harder or finding some other income; it is more difficult for an older person. If you were only to lose the income from rents for a few months, you could probably go back to full-time work for a while—but losing the income

and having to pay interest to a bank is a completely different story! Therefore, property works as a Security Asset (and a very good one) only if it has no borrowings.

If the difference between a property being a Wealth-Creating Asset and a Security Asset is whether or not it has debt, you can convert it from one to the other by repaying the mortgage. Indeed, there are people who adopt something like this as their long-term financial strategy. They buy two or three rental properties when they are in their thirties, with the plan of spending the next twenty years or so paying off the mortgages. In this way they end up in their fifties with some debt-free properties providing good income on which they can live. This is a good strategy for a lot of people—the gradual repayment of debt converts a Wealth-Creating Asset into a Security Asset at just the time you need it. The only thing you have to watch with this is that you might end up undiversified—that is, having a few properties, but not a lot else.

Property is a good Security Asset because it tends to provide quite high income. Better still, over a long period that income is likely to grow. Even a fairly ordinary property is likely to at least match inflation, meaning that you have an income that is inflation indexed for the rest of your life. In fact, most property gives growth that betters inflation, thus making up for the investments in your portfolio which do not show income growth (such as bonds). You will also have capital growth from your properties—good for people who want to pass assets on to the children as an inheritance.

There are three disadvantages to property:

- They are usually a big, expensive asset and will for a lot of people make up a big proportion of the total investment

portfolio. If the property part of your portfolio is represented by just one or two properties, you are subject to risk from having just one or two tenants in just one or two locations. This could leave you exposed to an event which could cost you dearly.

- The amount of money that is involved in property can mean that you go into property which is of fairly ordinary quality. While you do not have to buy the very best property in the very best location, you do want to buy things which are fairly good. These are expensive, and I do see people trying to stretch their money by purchasing things they would not otherwise buy.
- They require management. Property takes time to manage (residential property in particular). It is tempting to say that once you have eased back, you will have a lot more time and so will be able to well manage rental property—and this is true for a lot of people. But it is not true for everyone: I know people who have eased back and even ceased work completely who find themselves very busy, and wondering how they ever managed to fit in a proper job.

All three disadvantages (quality, lack of diversification and management) can be solved by investing in property via managed funds. These are funds such as listed property trusts and unit trusts which own large numbers of properties, sometimes worth hundreds of millions of dollars. They are all based on commercial property (retail, offices or industrial), sometimes targeting one particular area and at other times spreading around a range of property types. It is possible, indeed quite easy, to buy into a widely diversified holding of

quality property via managed funds, using the amount of money that you choose. The downside of investing in property via managed funds is that you have to pay the management costs of the trust that owns the property. This will eat into returns; however, the quality of the property and the professional management should make up for this. If it doesn't, get out and find a better performing fund.

I think, all else being equal, that people who are easing back should go into property directly if they have sufficient capital to avoid borrowings. Nonetheless, do not have too much in property (certainly less than 50 per cent). Other people should not ignore property, but go into it via managed funds.

Commercial versus residential

When most people think of rental property, they automatically think of residential property. I think this is a shame, because there are quite significant benefits from owning particular types of commercial property. On the whole, I am a great fan of industrial property. This is because:

- It is very low maintenance (they are usually very simple buildings with four concrete walls and an iron roof);
- It has low obsolescence (the kitchen and bathroom do not go out of fashion every ten years or so);
- It is low management (the tenant is often bound for years by a long-term lease and is responsible for a lot of the upkeep);
- It is relatively high yielding (the income compared to the purchase price is high); and

- It is relatively low cost, making it within the price range of some private investors (compared to office buildings and retail, anyway).

The reason industrial property is not very popular with a lot of private investors is that it is not as readily understandable as residential property and the lease arrangements seem to be quite complicated. Furthermore, while industrial property is not as expensive as office buildings, it is often more expensive than residential property. Nevertheless, as a good, steady income-earner with low maintenance and a low management-hassle factor, it is hard to beat industrial property.

Residential property works quite well as a Security Asset in most cases. However, the property you might own while building up your wealth could be quite different from what you own when you have eased back and are looking for income. Quite often, high capital growth property is not likely to also give high income. Typically, high capital growth properties are found in the very best locations (central city, desirable suburbs), but these areas are expensive and so do not give good income yields. These kinds of properties are very suitable for building up wealth, but are not likely to give you enough income on which to live. Less attractive locations will give you better yields, and it is these that I would seek out. I am not saying you should buy a tumbledown old building out in the boondocks, but you do not have to buy into the very best street in town either. Look for property that shows a good yield, but is well enough located so that it is likely always to have some demand from tenants. This new stage of life requires you to invest for income—capital growth is secondary.

About three years ago, I bought into a property trust based on industrial property (warehouses, factories and the like). I paid 80 cents a unit. The units are now trading at 105 cents—fairly good capital growth (although it has to be recognised that these have been very good years for property). However, better still are the dividends. When I purchased the units, they were paying 7 cents each—a yield of around 9 per cent p.a. Now they are paying 10 cents per unit—a cash yield on my original purchase price of 12.5 per cent p.a.

This illustrates the way that property can give income growth—an important reason for going into it. The capital growth from 80 cents to 105 cents per unit has been satisfactory, but only satisfactory. The income growth, from 7 cents to 10 cents per unit, has been everything I could have wanted. It is particularly good when you realise what a safe investment this is. The trust owns \$300 million worth of industrial property, nearly all of very good quality and spread around many different locations and cities. It has several hundred different tenants and the average lease expiry is six years. The trust has quite moderate amounts of debt. Those dividends seem fairly secure for a while yet!

Property is a very good Security Asset, a great store of wealth. The above investment seems far less risky, and with better returns, than the third or fourth tier finance company debentures that so many people look to for income.

Chapter 20 | The place of shares

When you first start to take life easier, shares should make up a major part of your investment portfolio—in the 10–50 per cent range. Shares have many of the same attributes as property—they give good income, capital growth and income growth. But, they have two things which property does not have:

- **Greater volatility** Shares do show a lot of ups and downs. Overall, and over a long period, they show very good returns. However, they can thrash around a lot (in a scary sort of way) while they give those returns.
- **Greater liquidity** Unlike property, shares are quite liquid—at most times, they are easy and cheap to cash up.

One of these two things (volatility) may be bad for some people. Although shares have always recovered from a major fall in the past, this may take a very long time, and it is certainly no fun knowing that the value of your life savings is significantly less, and may remain so for some years. The way to manage volatility is to diversify—across countries, across industries and across individual companies.

Nonetheless, you also have to acknowledge that there is a close relationship between the values of shares across countries, industries and individual companies—they will quite often all tend to move in the same direction. Diversification will help the overall volatility of your share holdings, but not altogether eliminate it. The volatility is the price that you have to pay to some extent for the good returns that shares give over time.

Disasters can happen when people buy into shares, disasters not so much concerned with the shares themselves, but with the volatility they show. The disaster happens when people buy into shares when there is a boom. They get caught up with all the hype (and the tales from family and friends about the vast profits made) and so they buy in. Their timing is usually at or near to the height. Then they hold on while the market inevitably falls, selling out a year or two after purchase, right at the bottom. This is human nature, and although it is easy to say that you should do the opposite of what everyone else is doing (buying when everyone else is selling, and selling when everyone else is buying), it is harder to actually do. You can use the volatility of shares to your advantage, but it takes patience and fortitude to stand against the tide.

One way to guard against volatility of shares is to consider investing in hedge funds. There are all sorts of these, some coming with a guarantee from a bank, which can make them quite a good Security Asset. There are also funds based on equities which have a mandate allowing them to sell shares short (and so giving investors good returns even in a down market). This provides some protection against volatility. Hedge funds often have high fees, however, and usually they do not pay out income to investors. Moreover, it can be slow

to cash up from hedge funds, a disincentive for those who want to sell units regularly to have cash to live on.

Liquidity, on the other hand, is an attractive feature of shares for some people. The ability to cash up quickly and relatively cheaply means that you can move out of a market when you feel the need. (This can of course prove to be a disadvantage, as a few people will often move in and out of the market at just the wrong times.) Nevertheless, the ability to turn your share investments into cash is an advantage of shares, especially for those who want or need to live off capital to some extent or other.

Growth or dividend yield

On the whole, shares which have high dividend yields show lower income and capital growth; conversely, shares which have high growth tend to have very low dividend payouts. While there have been plenty of exceptions to this rule it works most of the time. Usually, people who have started to ease back look for shares with high dividend yields to provide income. High dividend yield shares are often found in the utility sector—power and phone companies and so on. Usually these companies not only pay out a lot of cash as dividends but are also safer than most (people continue to buy electricity even when there is an economic downturn). Property companies and trusts also fit this category. Often there are quite good dividend opportunities with some other industrial companies, although these may be more affected by adverse economic events. People who are depending on their investments for income usually look for companies in the utility and property

sectors, and perhaps choose a few other companies which have a history of paying good dividends regularly.

However, you should not ignore growth companies. This is for two reasons:

- As growth companies increase their profitability, their dividends also increase. You may put \$10 000 into a company and only get \$300 in dividends in the first year. But if the company is successful, the dividends increase and, say, four years later you are getting \$1000 in dividends (the share price will also have grown).
- Shares are liquid, so it is quite easy to take out some of your capital profits by selling a small percentage of your holdings. For example, you buy \$10 000 of a company which is paying out no or at least very small dividends. The share price grows over a year so that you now have a holding worth \$12 000. You can sell \$2000 worth of shares, taking out the capital profit you have made. You could repeat this for as long as you like, perhaps not taking out all of your capital profits, to allow for inflation.

Growth companies tend to give better returns to shareholders. Even though they are often more risky and volatile, you should have some in your portfolio. Any halfway decent sharebroker should be able to build a portfolio for you, made up mostly of high dividend yield shares with a smaller proportion of growth shares. Look around—some brokers show on their websites typical high yield portfolios for clients needing income without too much volatility.

You can also enhance your income by doing some selective trading. This again is easier said than done, but one area

which is often fruitful is 'stagging'. This is to buy into initial public offerings, (that is, before a new company lists). The shares will often come onto the market at a premium, giving you a cash profit if you sell on the day of listing if you have been lucky enough to get some of the shares. You should not allocate much of your capital to trading—it is risky. For most people even 5 per cent would be too much.

If you don't want to manage your own share portfolio, you can opt for managed funds. I don't know of any managed fund based on shares which invests mostly in high dividend shares (which is a pity), but if you need income you can sell part of your holding each year, an amount that represents the returns you are getting. You need to be fairly careful with managed funds, however, as the fees charged by some of them can be very high. In particular, you should watch for high exit fees—some unit trusts put in a disincentive to selling by charging a fee for exiting (especially if you exit within a certain time-frame). Some brokerage houses will also manage your share portfolio. They will do the stock picking for you, hold the shares in trust for you, bank the dividend cheques for you, do your tax returns for you, etc. Obviously they charge for this service, but it does have an advantage in that the portfolio is tailored specifically to you and your situation.

In summary, most people should have a significant proportion of their Security Assets in shares. A spread of shares with a heavy weighting towards utility companies or those which are fairly mature should give good income along with some growth. Although shares are volatile, and can sometimes seem very scary, they do provide very good long-term returns. If you have just begun to (or are planning to) ease back, you will still have a long investment time-frame—

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probably a decade or two (or three). Dividends from shares in many markets at the time of writing are fairly low. Over time, however, a well-diversified share portfolio will give good income returns with some growth, along with the ability to withdraw capital when it is needed.

Chapter 21 | Living on capital

In easing back, some people will have to live on capital. If you think back to Section two (Do we have enough?), living on capital is one of the eight factors you can adjust and manipulate to be sure that you will have the income that you need to. Living on capital requires two things:

1. The acceptance of the fact that the inheritance you leave will be smaller (even though the cheque to the undertaker might not bounce, you will leave less behind).
2. A plan to make sure you can accommodate the mechanics and practicalities.

The acceptance of the fact that there will be less of an inheritance for those you leave behind is a matter of personal philosophy. Philosophy, however, must sometimes be overridden by necessity. I think nearly everyone wants to leave something behind for their family. A reasonable compromise for those of you who do need to spend capital is to keep the house unencumbered and to use the capital from savings and investments only. It has to be said, however, that there will

still be some who cannot afford to live as they want and still pass on the value of the house untouched.

The practicalities can also be awkward. Think back to the chicken farmer in Chapter 7: if you start to live on capital (killing chickens) your income (eggs) will be less. This will not make much difference at the start as you spend only a little capital, but as time goes on and more capital is spent, income returns will become less and less. Think of this like a mortgage that you are paying off over, say, twenty years. At the start, most of your monthly payments will be interest and only a little principal repayment. Over time this changes so that the last payment is mostly capital with only a small interest component. The bank will receive regular monthly payments, each of which is exactly the same. However, it will account for each payment differently, knowing that the interest and principal components differ over time. It also knows that one day the payments will finish.

The main difficulty with living off capital is this: How long can you do it for? When will it finish? Will you have to book into the local doss house? It is relatively easy to work this out: you can go onto a bank website and put the numbers into a mortgage calculator. In using a mortgage calculator you are looking at this from the bank's point of view, working out how much the payments will be and for how long, given a certain amount of capital and assuming a particular rate of return. You put in the investment rate of return you think you will get (where the interest rate is), the amount of capital you have (where the loan amount is) and the amount of time you want it to last for. This will give you the total amount that you can draw each month. If this is not enough, you may have to adjust one or more of the variables—expected rate of return and

length of time—until you get a suitable set of numbers. Using a mortgage calculator in this way will give you a theoretical amount which you can draw from your savings each month.

However, it is *only* theoretical, because the returns you get over a long period are unlikely to be smooth—there will be up times and down times. You should therefore be conservative with the numbers you put in. The whole point of this exercise is to ensure that the money does not run out before you do (leaving you resident in the doss house). Doing the numbers on a calculator like this will give you an indication, but it will not be something you can just set and forget. You will need to continually monitor what you have, adjusting as returns change over time. Perhaps most important is the amount of time your capital has to last. For most of us this will be a guess (fortunately), but it is a guess that should be made fairly conservatively, so set the time you want your capital to last a few years longer than your first thought.

Annuities

Annuities can give you certainty. The purchase of an annuity will give you a set amount of income (inflation adjusted if that is what you want) for a set period of time. In this respect it is very much like the reverse of a mortgage. With a mortgage, you take a large lump sum from the lender and drip-feed it back with regular payments; with an annuity, you give someone (usually an insurance company) a lump sum, and they drip-feed it back to you with regular payments.

An annuity is simplicity itself; the company takes your lump sum and pays it back with the investment returns over

an agreed period. A variation is to buy an annuity for life—that is, the company will pay you the agreed monthly payment until you die. If you put all your wealth into an annuity for life, the cheque to the undertaker would indeed bounce. The actuaries at the company work out how long you are likely to live—if you die early they win; if you hang on for years you win. (There was an interesting case in France a few years ago, where annuities are written by lawyers. A lady in her sixties took out an annuity. The lawyer died at about 80, but the woman lived to be 122!) Of course, the actuaries make sure that the odds are stacked in the company's favour—provided they have enough people taking annuities, they will have things worked out so that they are on the right side.

One of the downsides of annuities of this sort is that the investment returns are not likely to be high. The company will invest the money you give it very conservatively, and so the monthly payments will be worked out at a relatively low rate of return. You could probably do better investing yourself, but an annuity does provide convenience and certainty.

There is another form of annuity which is popular in some European countries in particular. In this annuity you use the house instead of a lump sum. The company takes a mortgage over the house and makes a monthly payment to you until you die or sell the house. When the house is sold, the company takes back the money it has paid you, with interest. This is being done around the world increasingly, in a form where the mortgage is taken by the company and you can draw on it as a loan up to a certain security level for whatever you like. These annuities or mortgages on the house (often called home equity release or reverse annuity mortgages) are a way of being able to eat your house while you live in it.

Shares

It is fairly easy to access capital from a share portfolio, simply selling some of your shares as and when you need cash. The problem with this in practice is that you don't know what future returns might be (shares are volatile) so you can never be certain how much you can cash up and still ensure that your money does not run out before you do. If you are selling shares, you should try to get the timing right by thinking well ahead and picking a time when the market is strong rather than being forced to sell into weakness.

Investment property

You can use capital to live on even when all your assets are in directly-owned investment properties. If your investment property rentals need to be supplemented by taking out some capital, there can be challenges, but there are some options:

- If you have more than one property it is fairly easy to sell one.
- If you have only one investment property, you could access capital by selling a share in it (perhaps to a family member). This would see you with part of your capital cashed up, and a proportion of the rent still coming in.
- If the second option does not work (no one is willing to buy a part of the property), you can access part of the capital you have in the property by borrowing. This will cut your income by the cost of the borrowing, but it should be able to be repeated as you need more capital.

- Sell your investment property and have your property exposure via managed funds or real estate investment funds which can be cashed up as you need.

Living on capital is an uncomfortable idea for a lot of people. If you have built up a lot of capital, you might never need to do so. But, if you do, there is almost always a way. Just make sure that you calculate the approximate amount of capital you can spend, and try to hold to that.

At 72, Rose was struggling to make ends meet. She had lived in her lovely big house for nearly thirty years, deciding to stay in it when her husband had died. However, although she loved the house and never wanted to leave, her small super annuation income was not stretching far enough to afford even her fairly modest lifestyle, and things like rates, insurance and maintenance on the house were getting to be beyond her budget. The house was valuable (around \$800 000) but she owned next to nothing else. Rose either had to sell the house and downsize or find a way of accessing some of the capital she had in the house.

She approached a financial services company, which would lend her money at 10.5 per cent. She did not so much mind the interest, but the idea of a mortgage on the house again after years of paying it off was unattractive.

Rose had a son and a daughter, both in their forties. Her son was working hard growing his business and could not help Rose financially. However, her daughter had just finished paying off her mortgage and was starting to invest quite good sums each month. Rose and her daughter discussed their respective situations and recognised that they

could cut out the middleman (the financial services company). Her daughter would give Rose \$600 per month by way of a loan at an interest rate the equivalent of their bank's variable rate (at the time 8 per cent). The loan would be properly documented and the interest accrued until Rose left the house, when her daughter would get her capital and interest.

This was a very good arrangement for both: Rose got a cheaper loan (without a mortgage) than she could otherwise get and knew that her daughter would one day be repaid, and the daughter got a higher rate of return than she might otherwise get. Rose's son knew of the arrangement and that it meant that one day his inheritance would be smaller, but was relaxed about it because his mother could happily stay in the house she loved so much and afford a better lifestyle.

Chapter 22 | Make every summer count

So, hopefully you've come away from this book inspired and feeling that if there was ever a time to get on with things, that time is now!

We all, at some point or another, talk about the things we would love to do. We all say things like: I would love to learn to paint; I would love to spend more time with my grandchildren; I would love to go to Egypt; I would love to work for a charity; I would love to . . . The trouble is, we usually follow this statement with the word 'but', and then the reason why we are not going to do what we say we want to do. The idea of thinking about the number of good summers ahead of us is so you will drop the 'but' and start getting on with doing the things you would really like to do. Remember, you can (and should) have the life that you want.

In generations past, our final decades were often characterised by skimping and making do, without the means (wealth and health) to be actively engaged in hobbies and sports. However, with the improved general health and life expectancy of this generation together with some sound financial planning, there's no reason anymore why these final decades can't be some of our best. If you know what

you want you can make it happen, providing you have the will and determination to force the changes. If you are not going to grasp the life that you want now, you may never do so.

It is your job to figure out how you want to spend your next years and how to rearrange and unlock the capital that you have. This may require some drastic action: perhaps giving up your job, selling the house, going to night school, getting out of the business. All change is difficult, and radical change even more so. And it is quite likely that radical change is what is required.

You may encounter some obstacles along the way: family and friends may show surprise, or even alarm, at the changes you are going to make; you will most likely experience money concerns (either real or imagined); your spouse may not be keen on having you working from home or selling one of the cars to help the budget, and so on. It is therefore important to keep sight of these two things if you are to overcome your obstacles:

1. Maintain focus on the life you want so you are constantly reminded that what you're doing is worth it. You may have to make some hard choices, and you will only be able to face these if you are convinced beyond doubt that what you are doing is right for you.
2. Plan—and plan early. More than anything I know, planning reduces fear of the future and fear of failure. Even a few ideas with some numbers scratched out on a sheet of paper will help defeat the insecurities that you might have. A more comprehensive plan made with the help of a good professional will obliterate them altogether.

MAKE EVERY SUMMER COUNT

There is still time to do all the things you have always wanted if you act firmly and decisively. There is not time for wishing, waiting and hoping though. You have to cut to the chase and start living the life you have always wanted.

If you are not going to have some good summers now, when are you going to have them? This is a serious question—you are never going to be fitter or more capable than you are now; you are never going to be in a better position to enjoy your life than you are now; you will never enjoy your time as much as you will now. If your life is not what you want it to be, change it. That may mean doing something quite radical, something that may raise the eyebrows of your family and friends. But it is *your* life—the only one you are likely to have in this world at least—so get on with doing what you want. If there was ever a time to do the things you have always wanted to do, this is it. It's time to make every summer count.